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A Dream and A Crisis: How American Political Ideology Caused the Financial Crisis

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A Dream and A Crisis: How American Political Ideology Caused the Financial Crisis

Abstract

This thesis will explore the relationship between political ideology at the Framing and how those mentalities transcended time to effect modern economic policies and cause the Housing Bubble of the 2000s and subsequent Financial Crisis. This will be done by first establishing property rights at the Founding of the nation, narrating government intervention throughout American history, and explaining the very government intervention which occurred that caused the Great Recession. Finally, this thesis makes recommendations to revisit the qualification of the American Dream.

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LAKE FOREST COLLEGE

Senior Thesis

A Dream and A Crisis: How American Political Ideology Caused the Financial Crisis

by

Aneesa Ahmed

April 27, 2015

The report of the investigation undertaken as a
Senior Thesis, to carry two courses of credit in
the Departments of Politics and Economics

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Dedication

I dedicate this thesis to my parents, who have unwaveringly supported me throughout my entire life. They have given me the means and tools to succeed and never cease in encouraging me to use them. To them, I owe nothing short of all of my accomplishments, achievements, and triumphs. Thanks, Mom and Dad, for everything.

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Chapter 1: Why the Financial Crisis and the Founders

"I want America to be an ownership society, a society where a life of work becomes a retirement of independence."

—President George W. Bush, February 28, 2002

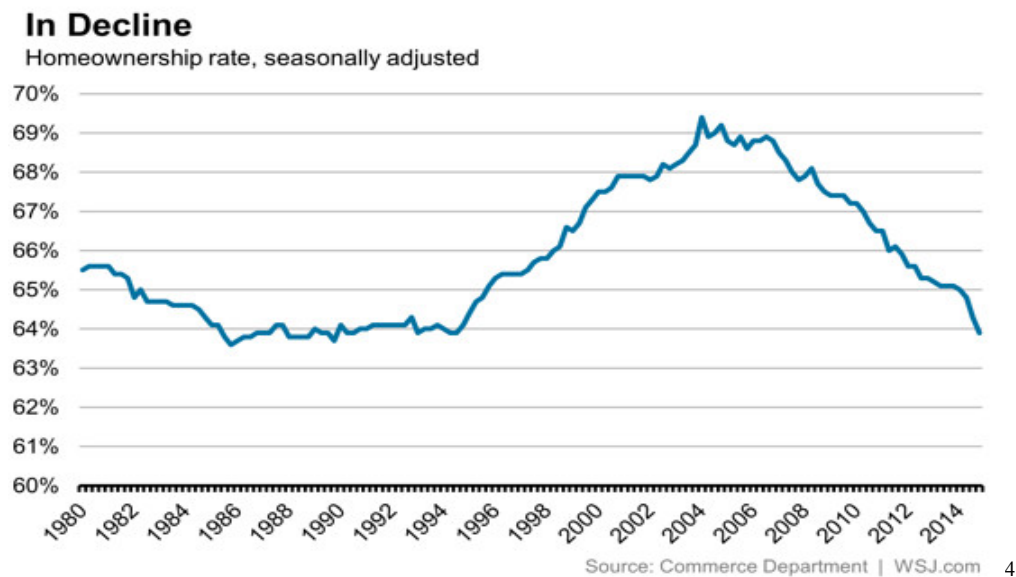
"The political institutions of America, its various soils and climates, opened a certain resource to the unfortunate and to the enterprising of every country and insured to them the acquisition and free possession of property."

—Thomas Jefferson, 1775

The most devastating economic event of this generation, the 2008 Financial Crisis will undoubtedly influence the political economy for generations to come.

Unemployment rates soared from 5.3 percent in 2005 to a high of 9.8 percent in 2010 and remained above eight percent until 2014.¹ Gross Domestic Product (GDP) steadily decreased from 2004 to 2010, and saw its largest drop in 2008 and 2009 when it plummeted from 1.1 percent to -4.1 percent.² The number of foreclosures in the nation rose from 801,563 in 2005 to 3,920,418 in 2011, resulting in homeownership rates to fall from 69.2 percent to 63.9 percent—lower than they were pre-Housing Bubble (see Figure 1).³

Figure 1 Homeownership Rates, Seasonally Adjusted



In attempts to unearth the actual foundations of the Crisis, politicians, economists, and theorists alike have debated the true source of the economic downturn and a myriad of reasons have been proposed. Some blame greedy bankers, some irresponsible borrowers and lenders. More still, blame the government, either for its action or inaction in the decade and a half leading up to the Crisis and in its aftermath.

What most fail to consider is the national ethos that surrounded the home buying frenzy that enveloped much of the 1990s and early 2000s. In attempts to create an “ownership society,” Presidents George W. Bush and Bill Clinton promoted public policy initiatives aimed toward increasing homeownership rates and ensuring that anyone could achieve the “American Dream.”

The “American Dream” evokes the notions of independence and freedom; freedom to achieve upward social mobility and the independence gained of having done so by oneself. It is the very fabric of the American identity. With it comes tangible acquisitions—material wealth that qualifies the achievement of the Dream. The most powerful symbol is the image of a house, usually surrounded by a white picket fence. The

idea of homeownership is unique in the American tradition in that it is the only universally accepted sign that one has “made it.” While the ownership of possessions may appear to be a modern construct, in actuality, the idea of property ownership as the qualifying characteristic of American citizenship and belonging is as old as the nation itself, and the relationship between property ownership and independence has its roots in the Founding.

At the nation’s creation, the Framers devised a system of governance to protect liberty and property, insisting that the former could not exist without the latter. While the concepts of what constitutes property have shifted over time, the idea of having a physical stake in the nation and its denotation of full membership into our society has perpetuated through time. What followed is an infatuation that this nation and its people have with homeownership.

Politicians do not exist in a vacuum, and like their constituents, are exposed to the same cultural ethos that the public is, and are likewise affected by it. The time leading up to the recent economic crisis was riddled with deregulation and economic practices that were all engaged in to appropriate all citizens into the American Dream. Financial institutions were encouraged and at times even forced to follow the government’s lead and partake in housing initiatives that advocated for equal opportunity in ownership, all of which was driven by a national tenet of an ideal society hallmarked by widespread property possession.

The economic practices that caused the financial crisis have their roots in mandates from the government, which themselves are entrenched in deep-seated political ideologies that were established during the Founding of the nation. Any discussion of the financial crisis and the government’s role in it must include this claim. Most theorists,

however, do not do this, and limit their evaluation of the causes of the financial crisis to that of purely economic practices or governmental legislative efforts. What they do not seek to explore is the philosophy behind the government's efforts to support widespread property ownership. This thesis does, and in it contains an examination of the American Founding principles of property rights, and how those rights transcended time, creating a culture that strove for ownership, which eventually had devastating effects, ironically collapsing the housing sector, and bringing down the entire economic system with it.

The first part of Chapter 2 surveys the literature surrounding homeownership and its ties to the American Dream as well as how homeownership has developed through the American psyche over time. Here, the importance of homeownership in America are established and serve to show how intrinsically tied homeownership is tied to the concept of the American Dream. The second part of Chapter 2 gives an overview of the financial crisis, as well as defines particular terms and outlines banking mechanics. This section works to demonstrate the tangible, economic effects that a nation of homeownership causes. In Chapter 3, the ideologies of three Framers are explored, specifically their beliefs concerning property rights and how they affected the crafting of the American governance system. In this chapter, the origins of the importance of property ownership are established, and serve as the basis for all analysis of property rights throughout this thesis.

Chapter 4 details the contention between the theoretical aspirations of a limited government in the realm of private property and its practical applications. In it, it becomes clear that while the Framers initially sought to limit the government's intrusion on private property, in order to build a nation, and serve the populace, certain allowances were given for governmental intervention. What this chapter serves to do is indicate that

there is a longstanding institutional legacy of government interference for the sake of serving the public good. This tradition perpetuated throughout time, and resulted in the government initiatives that caused the Financial Crisis of 2008. Chapter 5 recounts the government intervention that caused the Housing Bubble and the subsequent Crisis. This chapter explains that the government's attempts to preserve founding ideologies of widespread property ownership had highly negative economic consequences.

Finally, Chapter 6 postulates a change in the American Dream, and proposes different approaches to preventing another financial crisis and alternative means to qualifying American Identity.

Chapter 2: A Dream and a Crisis

The American Dream

James Trunslow Adams first crafted the term the “American Dream” in 1931 with the publication of his book entitled, *The Epic of America*, where he defined the Dream as,

a land in which life should be better and richer and fuller for everyone, with opportunity for each according to ability or achievement... It is not a dream of motor cars and high wages merely, but a dream of social order in which each man and each woman shall be able to attain to the fullest stature of which they are innately capable, and be recognized by others for what they are, regardless of the fortuitous circumstances of birth or position.⁵

Adams' ideology is a part of the American philosophy, where, above all, freedom of opportunity and prosperity are protected. Amongst these freedoms is the freedom of upward social mobility which has called millions to the United States in its nearly two and half century existence. These ideas of freedom were not created during the 1930s, when Adams wrote his book; however, Adams' term was a vocalization of longstanding principles in the American tradition, namely the protection and promulgation of equality

and the rights to life, liberty, and the pursuit of happiness, as dictated in the United States Declaration of Independence.⁶

Today, the Dream encompasses a variety of opportunities and has changed from its original inception. The rights to education and healthcare have been enveloped into this ideology by both society and the government; however, one of the longest standing components of the American Dream has been the right to property ownership. This is an ideology that predates the American Founding, to the period of Colonization, when the individuals who initially settled in the New World were frequently paid in parcels of land that they were expected to cultivate.⁷ This contract gave way to the idea of the Yeomen Farmer, which later became the idolized citizen model in the Jeffersonian perspective.⁸

Due to ties of property ownership, specifically the idea of “active property ownership”⁹ which encompassed not only owning land, but working on it for sustenance and autonomy, there emerged a relationship between responsible citizenship and property ownership. Indeed, when looking at state constitutions of the 13 original Colonies, property ownership was a prerequisite for the right to vote in every one.¹⁰

Jefferson in particular relied heavily upon the Virginia Declaration of Rights when crafting the American Declaration of Independence. The Virginia Declaration of Rights states,

That all men are by nature equally free and independent and have certain inherent rights, of which, when they enter into a state of society, they cannot, by any compact, deprive or divest their posterity; namely, the enjoyment of life and liberty, with the means of acquiring and possessing property, and pursuing and obtaining happiness and safety.¹¹

It should be noted that the Virginia Declaration of Rights explicitly states that the possession and acquisition of property are two fundamental rights to be protected. This language is indicative of the government’s responsibility to not only protect the rights of

property ownership, but also those of property acquisition, indicating that the propertyless still have protected rights in their ability to eventually become property owners.

Due to the inclusion of property rights as a requirement for the right to vote, there would appear to be some intrinsic superiority of property owners over non-property owners. John Adams postulated that, “Is it not...true that men in general, in every society, who are wholly destitute of property, are...too dependent on other men to have a will of their own?... Such is the frailty of the human heart, that very few men who have no property, have any judgment of their own.” The origins of the virtue of property ownership in the American tradition are, by Adams’ own dialogue, rooted in independence and freedom, two things that are the very foundation of Americanism and were often echoed by Adams’ Revolutionary contemporaries. This ideology became wholly ingrained in the American spirit and evolved to be an inherent aspect of what it means to be American.

Eventually, the ties between property ownership and American identity became implicit, with leaders in government, the private, and public sectors advocating for wider spread property rights which they argued were inherently American. From the Founding to the administrations of modern presidencies, there has been a perpetual call to ensure that, “everyone who wants to own a home has got a chance at doing so.”¹²

While widespread homeownership has been a longstanding part of the American tradition, the push for every American to own a home eventually came with a catastrophic price, sending the banking sector into a freefall and led, paradoxically, to hundreds of thousands of American eventually losing their homes.

Looking at legislation and economic history, many look to pinpoint where exactly the turning point in property ownership occurred. In simpler terms: where did it all go wrong? Where was the threshold when housing for all Americans became a liability as opposed to an achievement of enduring promises set forth by fundamental American ideals? To answer this question, we need to look at the course of property ownership, and eventual homeownership, throughout the nation's history. While this is a vast chronicle, there are distinct tipping points in its history.

The Founders did not value property ownership for the mere sake of ownership, but rather for its productivity.¹³ The United States was constructed upon the idea of individual ownership of property as means for production, most notably farming. In the Colonial Era, owning property was considered a right of the individuals who established the Colonies. Indeed, many were paid in land with the expectation that they would cultivate it.

Documentation that chronicles the American Founding notes that the Framers believed that every American was entitled to the “means of acquiring and possessing property.”¹⁴ The Framers were largely influenced by the ideology of John Locke, whose ideas about liberty, society, and government are reflected in a myriad of American documents such as the Declaration of Independence. Later, in campaigns to promote the acceptance of the newly written Constitution, the Founders, in publications such as the *Federalist* and *Anti-Federalist Papers*, emphasized the linkages amongst property ownership, economic autonomy, and political freedom.¹⁵

James Madison was one such Framer who advocated heavily for the protections of private property. In the *Federalist Paper #10*, of which Madison is generally recognized to have authored, he wrote, “The diversity in the faculties of men, from which

the rights of property originate, is not less an insuperable obstacle to a uniformity of interests. The protection of these faculties is the first object of government.”¹⁶ Here he notes that the primary intent of an American government must be, above all, the protection of property ownership. Madison and other Federalists defined the purpose of good government as, “a matter of protecting the rights of both people and property.”¹⁷ While protecting citizens is essentially universal, there is a distinction in regards to property. It was thought that those without property couldn’t be relied upon to contribute to its preservation.

Additionally, with legal protection of property, owners of property would have enough economic security to challenge those in power. The existence of an abundance of owners would then counterbalance an overreaching government. Utilizing this line of thought, property ownership was the only way to achieve political freedom. Land ownership was imperative for economic independence, and from economic independence, came liberty.¹⁸

In *Democracy in America*, de Tocqueville notes that even the United States’ inheritance laws, which distinctly omit the mandate of primogeniture, unlike its English counterparts, perpetuated the idea of equality due to the fact that instead of the eldest male being the sole recipient of property, theoretically, all children would have an equal right to inherit.¹⁹ Incidentally, it should be noted that primogeniture was one of Adam Smith’s complaints against the property rights in England in the same era. Smith’s argument was that primogeniture led to allowing land to “rest,” meaning that the development of land was often neglected due to automatic inheritance.²⁰ Thus, the equal opportunity of inheritance should be promoted due to the fact that innovative and efficient usage of the land was more likely to occur under those new paradigms. Thus, it

is clear that the idea of productive property ownership was not unique to the Colonies; however, it was a growing sentiment in the political sphere of the Era. Smith's ideology, more notable for its advocacy for Laissez-Faire governance and economics is mirrored in the limited government style the Framers established. Indeed, for more than 150 years after the nation's founding, Laissez- Faire economics was the model that the United States followed.

Property Ownership and Engaged Citizenry

There has been a longstanding linkage between political representation, participation, and land ownership. In Colonial America, land ownership was as much a part of a person's character and identity as religion and gender were, and while almost every state alleviated its property ownership conditions for Suffrage, the fact remains, that it once was a strict requirement.²¹

In the period of Confederation, property ownership requirements were relaxed and the right to vote became contingent on property taxes or general taxpaying. This indicates that ownership was still imperative, stemming from the ideology that ownership was equated to "having a stake" in the preservation of property rights, which would mean more meaningful civic participation.²²

Even to this day, there are limitations on citizens' rights to vote based on property ownership. In many states, those who are homeless face impediments in exercising their rights to vote. Registration requirements vary state to state, but in many of them, permanent residency or residency at all is a requirement for voter identification cards. Residency is also imperative so that each citizen can be placed in a district where he or she may vote for his or her Members of Congress or City Council and a host of other elected representatives. While this intuitively makes sense, it does leave out a portion of

the populace that is, due to the mechanics of the voting process, barred from exercising voting rights due to a lack of property ownership.

Additionally, Freed slaves were promised “40 acres and a mule” after the end of the Civil War.²³ The term refers to reforms that were aimed to help integrate formerly enslaved African American into society. Due to their continuous work on farms, many Freedmen believed that they had a natural right to the land they and their families had worked on for generations. Sherman’s Special Field Orders No. 15 declared government appropriated land was to be divided into plots of 40 acres and settled by Freedmen for their own work and sustainability. These promises were eventually negated when President Johnson pardoned Southern landowners and restored their ownership during the Reconstruction Era.²⁴ The fact that land was used to aggregate Freedmen into society is demonstrative of the importance that property ownership has in American citizenship. Instead of promising equitable hiring rights, mandated education, or any other aspects of social and economic integration, freed slaves were promised property, something that was clearly considered the most imperative in the amalgamation of African Americans into the rest of the citizenry.

The Diffusion and Commodification of Homeownership

The Jeffersonian call for widespread property ownership was still heeded 150 years after its origin. In the 1920s, there was a call by both leaders of government and captains of industry to create a wider “diffusion of property ownership.”²⁵ Then Secretary of Commerce Herbert Hoover stated in a speech to the Academy of Political Science Dinner in March of 1925 that,

one of the continuous and underlying problems of sustained democracy is the constant and wider diffusion of property ownership. Indeed, I should become fatalistic of ultimate destruction of democracy itself if I believed that the result of all of our invention, all of our discovery, all our increasing economic efficiency

and all our growing wealth would be toward the further and further concentration of ownership.²⁶

The fear of highly concentrated property ownership was not a newly founded fear at the time, however it was exacerbated by the recent world war and the economic stresses on the European continent. Hoover's statements reflected the everlasting issue of property ownership, that being, that it has continuously been viewed as a tool for the citizenry to control its government, and the less people who have that tool, the worse off the country is.

In the inter-war period, riots began due to post-World War I housing shortages, prompting Hoover to create his "Own Your Own Home" campaign, which was meant to restore political stability by tying workers to a piece of property and a mortgage.²⁷ During this time, the government broadened the idea of working-class citizenship to include homeownership and enacted legislation to make housing more widely available to citizens in conjunction with this campaign.²⁸ It was eventually due to the civil unrest caused by the disparity in homeownership during inter- and post-war eras that prompted more relaxed regulations for homeownership, the most notable being the Housing Acts of 1934 and 1949.²⁹

In 1934, one of the most impactful pieces of New Deal legislation was passed—the National Housing Act of 1934, which created the Federal Housing Authority (FHA). The FHA established and guaranteed the amortized mortgage and developed insurance, property, and financing standards.³⁰ The FHA also oversaw the materials used in FHA-approved houses which, from 1934 to 1957, accounted for about 30 percent of all homes built in the country. The government thusly oversaw the process of consumption and production, thereby allowing the full commodification of the housing industry. Due to the increased ease of buying and selling property, "an ethos of trading up to bigger, more

expensive houses” was created.³¹ Restructured mortgage lending policies made houses easier to pay for, and housing became not only a commodity, but an affordable one.³²

In President Truman’s own words, the Housing Act of 1949, “establishes as a national objective the achievement as soon as feasible of a decent home and a suitable living environment for every American family... These policies are thoroughly consistent with American ideals and traditions.”³³

The Act was a part of President Truman’s Fair Deal program, and extension of President Franklin Roosevelt’s New Deal programs, as well as a fulfillment of a promise made in his State of the Union address. The plan increased the federal government’s role in mortgage insurance and the construction of public housing. The Act provided federal financing for slum clearing as a part of urban renewal projects, increased FHA mortgage insurance, used federal money to buy more than 800,000 housing units, funded research for housing and housing techniques, and allowed the FHA to provide financing for homeowners in rural areas. The act also delegated to Congress the task of creating low-rent public housing, increasing units to one million over the following seven years.³⁴

Considered one of the greatest pieces of legislation in the 20th century, scholars note that it achieved one of the greatest goals of the 20th century, that is, the democratization of homeownership. The goals of the Act, however, took over two decades to be finally realized, and during its initial stages, the Housing Act displaced lower-income families and helped propagate the deeply seated racism of the time. In fact, cities’ segregation was made more pronounced during the initial stages of its implementation due to the fact that most people who fell into the low income bracket were minorities. The displacement of these groups resulted in heavily concentrated areas populated by predominantly African American tenants, and those racially segregated

neighborhoods remained for decades, some even until today. These faults were somewhat remedied when the Housing and Urban Development Act of 1965 and the Fair Housing Act of 1968 were passed. Both pieces of legislation realized the Civil Rights Movement's goals of equitable housing. Although amended and reincarnated for decades after its initial passage, the initial Act remain one of the most fundamental and revolutionary housing initiatives in American history.³⁵

Private and public sectors alike were concerned with the growing concentration of wealth in the United States. Not only from an economic viewpoint but also a social standpoint, with the common manner of thinking being that the growing middle class would become revolutionary (in a manner not unlike the American Independence movement) if they did not have a stake in the future of its nation. The solution to that concern was a higher diffusion of property ownership amongst members of the middle class. Secretary Hoover pushed for that property to be literal property, working to make possible higher homeownership rates in the inter-war period. He reasoned, in many writings and speeches, that if homeownership increased, people would have a higher stake in the future of the country due to the fact that they now tangibly owned some of it. This would cause greater discourse and participation, and generally make individuals better citizens.³⁶

Both the private and public sectors heeded the government's call for increased homeownership. The increase in homeownership, however, eventually led to the point where mentalities concerning ownership changed. At this point, houses became commodified and viewed by the populace as a good, and not just an achievement of American ideals. In his essay, "Framing the American Dream," David Monteyne discussed the standardization of architectural framing and how it hallmarked the

increased commodification of housing in the United States. The author notes that the perpetuation of the American Dream in pre-, inter-, and post-war eras created “over-the-counter” homes and the Ford-like manufacturing of houses helped actualize what he called a “Fordist Republic of dependent consumers.”³⁷

In the 1920s, houses were built utilizing high specialization which allowed homes to be built using construction methods not unlike those of Ford’s Model-T cars. The rise of the subdivision saw the ascent of what was called the “minimum house,” houses that were identically designed and quickly produced to meet the demand of growing homeownership.³⁸ The ready-cut industry that emerged in the 19th century consisted of catalogs of homes with fixed prices, making houses much like any other commodity. Akin to picking out clothing, one could pick out a home. Sears Roebuck was one retailer that sold clothing, appliances, and also homes leading to, “the increase in the commodification of the house” which, “largely eliminated the home’s symbolic function as a family heirloom or any sense of it as a life-time purchase.”³⁹ This is the time that individuals shifted from being homeowners to “home marketers” and began thinking of houses as any other commodity, establishing new beliefs that devalued homeownership morally while increasing its value as an investment, much like stock in a company.

Ethical Homeownership

The increase in “house marketing” and its prevalence in American homeownership gave rise to the discussion of ethical homeownership—its meaning, importance, and relevance in society and history, as well as its impact on the economy.

The idea of ethical homeownership has persisted through history, with political theorists discussing the morals of homeownership. In the light of the recent economic downturn, retrospective thinking has led many to view owning a home as not just a

financial investment, where houses are seen as assets and wells of credit, but as moral contracts, where mortgages are seen as a fulfillment of a commitment.

Some political theorist make a distinction between moral homeownership and commodified homeownership and it would appear that the mentalities that perpetuated the financial crisis are rooted in the widespread exhibition of the latter. The distinction between moral homeownership and commodified homeownership lies in the usage of the house. Moral homeownership is typified in the usage of a home as a place of living, a place to cultivate one's life. Commodified homeownership is the usage of a home to make a profit, or for mere financial reasons such as investment. The switch in the prevalent ideology from moral homeownership to commodified ownership is the juncture where the government's push of making homeownership more affordable and attainable began doing more harm than good, and the harm it caused eventually led to large-scale speculation, a housing bubble, and later, collapse of the housing market which was one of the primary causes of the 2008 financial crisis.⁴⁰

Avramenko and Boyd laid out a series of "sub-prime" virtues that they believe, if encouraged by the public and private sectors alike, will not only improve the housing markets, but will also produce a series of positive externalities that will in turn generate higher social benefits. In describing what they call "subprime virtues" the authors cite Aristotle, Aquinas, and Hegel, who the authors believe share the idea that, "political communities have an obligation to foster a set of prime...virtues among the citizenry and to actively propagate shared visions of the good."⁴¹ They mean that the government has a responsibility to guide the public's morals in order to sustain public good and civic identity.

If “politics creates policies, policies also remake politics” the symbiotic relationship between politics and policies can most readily be seen in the various pieces of housing legislation from the Founding, to the Civil War, the Post-War Era, the Civil Rights Era, and finally to the housing initiatives in the 2000s.⁴² Andrea Louise Campbell stated that “government policy fundamentally transforms its target population,” meaning that potential housing policies and initiatives have the power to influence the citizenry’s actions.⁴³ While this may seem intuitive, this can mean that certain allowances that the government makes may encourage behavior that citizens may not have otherwise engaged in. All of a sudden, if something is legal, or better yet, encouraged by the government through subsidies or credits, people who otherwise would not partake in activities would, due to the incentives.

Similarly, housing policy can be a tool for instructing or discouraging certain civic virtues. The policies of the 20th century that were intended to bring homeownership to all Americans caused consequences that were not only damaging economically but detrimental to the morals of the populace. Avramenko and Boyd go on to state that instead of promoting homeownership, housing policies encouraged house flipping and the retraction of morals from homeownership.⁴⁴

Looking Forward

The “ownership society” is integral in the American identity.⁴⁵ While it does pertain to homeownership, the idea of homeownership is more than just the tangible aspect of owning property; it is the act of consciously putting down roots and engaging in the surrounding community. While there is little debate over the existence of an intrinsic relationship between homeownership and the American identity, this thesis argues that that relationship, the perpetuation of the so-called “American Dream,” has negatively

affected the American psyche, resulting in governmental action, and also inaction, that allowed a housing bubble to develop which eventually burst and led to the Financial Crisis of 2008. It is still quite obvious that the idea of homeownership for all, even after the Crisis, is very much a part of the American ethos, but how the government, private sector, and the American citizenry reconcile this ethos with the reality of a recovering economy will remain to be seen.

A Crisis

In September of 2008, Lehman Brothers, the American-based global investment firm, filed for bankruptcy. In what was to become the largest economic crisis since the Great Depression in the 1930s, the closing of Lehman Brothers was the beginning of a series of collapses that plagued the Great Recession. After nearly two decades of industrial growth, record-breaking trading, and a housing market boom that seemed unstoppable, the sudden economic decline starkly contrasted with the fervent success of the previous 20 years.

The housing boom of the late 1990s and early 2000s profoundly shifted the way in which the banking industry operated, that much is certain. A less obvious, but equally important change that occurred was the way in which individuals viewed themselves and others in relation to the economy. Richard Shiller stated that,

That boom involved a transformation of people's thinking about their role in the economy. The idea developed that we ought to expect to make a lot of money investing. The transformation went well beyond opinions about particular investment strategies to alter the very self-esteem mechanism that supports our egos. The Protestant work ethic that had underlain the national psyche for so long underwent a makeover. To a substantial extent, we no longer admired those who were merely hard workers. To be truly revered, one had to be a smart investor as well.⁴⁶

Shiller succinctly sums up one of the less tangible, but nonetheless essential outcomes of the financial crisis: a change in society's psyche.

Trying to figure out how we got to this economic state takes more than looking at big banks and blaming irresponsible lending. Indeed, there is more to this story, which was, in fact, decades in the making. Looking at public policies that created the Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac), as well as international statutes and the perfect storm of aggressive mortgage lenders and ignorant borrowers, it is obvious that the housing bubble, its burst, and the ensuing financial crisis is a complex narrative that encompasses both political and economic agendas.⁴⁷

Housing prices and homeownership began to increase in the mid-1990s, and the boom continued until 2006 when prices began their rapid decline. Purchases of real estate, for the prior decade and a half, had appeared to be a sound investment that could provide financial security and even a path to greater wealth. Looking at Table 1, the United States Census Bureau reported that homeownership rates rose five percent in the decade between 1994 and 2004. The national homeownership rate had remained level at 64 percent since the 1970s, and this sudden increase in a relatively short time span constituted unparalleled growth.

The increase in homeownership rose especially for minority homeowners under the age of 35. From 1995 to 2006, homeownership rates for African Americans rose from 42.7 percent to 47.9 percent while the rates rose from 42.1 percent to 49.7 percent for Hispanics which constitutes the largest increase in homeownership rates for any demographic.

Table 1: Homeownership Rates 1994-2012, By Race

	1994	1995	1996 ¹	1997	1998	1999	2000	2001	2002	2002 ¹
U.S. total.....	64.0	64.7	65.4	65.7	66.3	66.8	67.4	67.8	67.9	67.9
White, total.....	67.7	68.7	69.1	69.3	70.0	70.5	71.1	71.6	71.8	71.7
Non-Hispanic White.....	70.0	70.9	71.7	72.0	72.6	73.2	73.8	74.3	74.5	74.7
Black, total.....	42.3	42.7	44.1	44.8	45.6	46.3	47.2	47.7	47.3	47.4
All Other Races, total.....	47.7	47.2	51.0	52.5	53.0	53.7	53.5	54.2	54.7	54.5
American Indian or Alaskan Native.....	51.7	55.8	51.6	51.7	54.3	56.1	56.2	55.4	54.6	54.0
Asian or Native Hawaiian/Pacific Islander.....	51.3	50.8	50.8	52.8	52.6	53.1	52.8	53.9	54.7	54.6
Other.....	36.1	37.4	NA	NA	NA	NA	NA	NA	NA	NA
Hispanic or Latino.....	41.2	42.1	42.8	43.3	44.7	45.5	46.3	47.3	48.2	47.0
Non-Hispanic.....	65.9	66.7	67.4	67.8	68.3	68.9	69.5	69.9	70.0	70.2
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
U.S. total.....	68.3	69.0	68.9	68.8	68.1	67.8	67.4	66.9	66.1	65.4
White alone, total.....	72.1	72.8	72.7	72.6	72.0	71.7	71.4	71.0	70.3	69.8
Non-Hispanic White alone.....	75.4	76.0	75.8	75.8	75.2	75.0	74.8	74.4	73.8	73.5
Black alone, total.....	48.1	49.1	48.2	47.9	47.2	47.4	46.2	45.4	44.9	43.9
All Other Races alone, total ²	56.0	58.6	59.2	59.9	59.2	58.5	57.8	57.0	56.4	55.0
American Indian or Alaskan Native alone.....	54.3	55.6	58.2	58.2	56.9	56.5	56.2	52.3	53.5	51.1
Asian or Native Hawaiian/Pacific Islander alone.....	56.3	59.8	60.1	60.8	60.0	59.5	59.3	58.9	58.0	56.6
Hispanic or Latino.....	46.7	48.1	49.5	49.7	49.7	49.1	48.4	47.5	46.9	46.1
Non-Hispanic.....	70.8	71.5	71.2	71.2	70.5	70.3	69.8	69.4	68.7	68.2
	2013									
U.S. total.....	65.1									
White alone, total.....	69.6									
Non-Hispanic White alone.....	73.3									
Black alone, total.....	43.1									
All Other Races alone, total ²	55.1									
American Indian or Alaskan Native alone.....	51.0									
Asian or Native Hawaiian/Pacific Islander alone.....	57.4									
Hispanic or Latino.....	46.1									
Non-Hispanic.....	67.9									
NA Not Applicable.										
¹ Beginning in 1996 to 2002, those answering 'other' for race were allocated to one of the 4 race categories-- White, Black, American Indian, Aleut, or Eskimo (one category), or Asian or Native Hawaiian.										
² Asian, Native Hawaiian or other Pacific Islander, American Indian or Alaska Native (only one race reported) and Two or more races.										
¹ Revised based on the 2000 Census.										

Source: Table 22. Homeownership Rates by Race and Ethnicity of Householder: 1994 to 2013." *Census.gov*. United States Census Bureau, 7 Mar. 2014. Web. 1 Apr. 2015. <<http://www.census.gov/housing/hvs/data/histtab16.xls>>.

This increase was the realization of nearly a century’s worth of public policy initiatives that sought to democratize homeownership and allow for more citizens to achieve the widely perpetuated idea of the “American Dream.” The Dream, which envelops a sentiment of property ownership as a part of overall citizenry, is the longstanding ideology about what it means to be American, and conveys a sense of belonging to the greater society. High homeownership rates are beneficial to society, that cannot be denied; new construction of homes positively contributes to GDP but also

otherwise contributes to areas due to increased investments in local communities and indicates the much sought-after achievement of upward mobility that the nation's political ideology is built upon. The one aspect of increased homeownership that is often times difficult to recognize is that homeownership is not, as Robert Shiller puts it, "the ideal housing arrangement for all people in all circumstances."⁴⁸ In retrospect, Shiller's statement is acutely accurate.

Last Time

During the last housing crisis in 1925-1933, home prices fell over 30% and unemployment rose to roughly 25%. To mitigate the effects of Great Depression, President Franklin Roosevelt installed a series of work programs as well as banking reforms and housing initiatives in his New Deal. In the time directly preceding the Great Depression, most borrowers took out mortgages that spanned five years or less which they would then expect to roll over before their contracts were due. As the Great Depression took hold, new homeowners found themselves unable to refinance their homes, which about 30% of them eventually lost.⁴⁹

In 1933, at the end of President Hoover's administration, Congress enacted a new bankruptcy law which allowed for average citizens to accept bankruptcy protection. When Roosevelt took office, he signed off on the Home Owners' Loan Corporation (HOLC), which lent to local home financial institutions and took on risky mortgages as collateral, thus creating a government subsidy of homeownership. With that, however, the HOLC mandated that new mortgages all be backed using a 15-year time frame and that they were both fixed-rate and self-amortizing. This meant that they were paid off steadily via monthly payments and that there were not large payments due at the maturity of the contract.⁵⁰

The FHA perpetuated the HOLC mandates by increasing mortgage time frames to 20 years. These mortgages were also fixed-rate and self-amortizing and eventually the time frame was expanded to the standard 30-year mortgage. The 30-year expansion was due to the mortgage holders' need to ensure that monthly payments would be manageable for homebuyers. Thus, instead of higher monthly payments for shorter time spans, lower payments over a longer time span meant that homebuyers were more likely to honor their mortgages and less likely to default.⁵¹

The 2008 Financial Crisis: An Overview

This financial crisis was a result of government action and inaction, a consequence of policy failures and misconstrued policy goals. The debate that economists argue over is whether the Crisis is an effect of capitalism or governmental policy. Since capitalism is given necessary constraints by the government, the Crisis is then, a failure of politics, facilitated by political initiatives that caused financial ruin.⁵²

The deflation of the subprime mortgage bubble was the direct cause of the financial sector downfall, that much has been definitively established.⁵³ Subprime lending practices, however, are only one part of the narrative. The financial sector encompasses the banking sector, thus, it is imperative, then, that any explanation of the Crisis explore the relationship between the banking sector and the housing market.⁵⁴ That is the way in which we can also explain how the housing market brought down the "real" economy of the world, that is, the nonfinancial economy encompassing businesses and all other types of industry.⁵⁵

What is imperative to remember, however, was the establishment of the subprime markets and the issuing of subprime loans was incentivized and accomplished in order to fulfill a highly important public policy goal: the democratization of finance. The

democratization of finance and more specifically, homeownership has already been discussed from a public policy perspective. From an economic perspective, however, Shiller notes its value and states that, “the democratizing of finance is crucial in this process: by spreading risk, it places economic life on a firmer foundation. Financial democracy is thus not only an end in itself, but a means to another, equally worthy, end: the propagation of greater economic stability and prosperity by financial means.”⁵⁶

Looking at decades of public policy goals regarding increased homeownership, from the New Deal to the Civil Rights Act, the formation of the Federal Housing Authority (FHA), to the Fair Housing Initiatives Programs propagated by the Department of Housing and Urban Development (HUD), wider spread homeownership has been a goal of the United States government since the Great Depression. Owning a home, especially in the post-War era, is seen as the realization of the American Dream, the fulfillment of a promise of economic upward mobility, an ideology that has drawn waves of immigrants to this nation for nearly a century and a half. What came after this democratization was, of course, increased ownership, however, through the practices of subprime lending and securitization that resulted in an increased amount of risk in the market.⁵⁷

Government Action

Three specific government acts caused the creation of the housing bubble and the Crisis: the passage of the Community Reinvestment Act (CRA) and the establishment of Fannie Mae and Freddie Mac. The Community Reinvestment Act (CRA), initially enacted in 1977, was passed largely in order to rectify the inherent racism present in previous housing initiatives. The Act mandated that all commercial banks that were FDIC-insured mortgage lending institutions make concerted efforts to aid the poorest members of the surrounding communities. The government-sponsored enterprises

(GSEs), Fannie Mae and Freddie Mac were created by Congress for the purpose of repurchasing mortgages from commercial banks so that banks would be more willing to issue new mortgages, which increased their liquidity, thus, spreading the opportunity of homeownership to more people. Fannie and Freddie then would package and pool the mortgages they bought and sell them to institutional investors in the form of mortgage-backed securities (MBS).⁵⁸ MBS are asset-backed bonds. A bond is essentially a promise to pay the holder a certain amount of interest as well as the principal over a period of time. An MBS is an asset-backed bond where the source of the interest payment is not, as with other bonds, a government or a corporation, but a pool of assets, in this case, mortgages.⁵⁹

These assets were then given the highest of ratings, AAA, from the three rating agencies, Standard and Poor's, Fitch, and Moody's, thus implying that the MBS were investments of minimal risk. It was later discovered, however, in the very midst of the Crisis, that the three agencies' ratings were misplaced, due to oversights and miscalculations.⁶⁰

Eventually, it wasn't just investment banks that purchased these assets. Mortgage companies, finance companies, as well as insurance companies and pension funds began to invest in these assets, which were all backed by mortgages, and many millions of which were insured by Fannie Mae and Freddie Mac. The GSEs guaranteed the payments of these mortgages regardless of whether or not the mortgagors defaulted, thus, acting as a type of insurer for these assets. These assets that were securitized by the GSEs appeared to be, at any rate, a sound investment. The Congressional charters of both Freddie Mac and Fannie Mae indicated that if they were to reach insolvency, the federal government

was obligated to bail them out. Indeed, this is what happened in early September of 2008.⁶¹

Fannie Mae and Freddie Mac were both proscribed from purchasing subprime loans. So then why mention them? The GSEs insured what are called, “high loan-to-value loans” and were designed to help low-income borrowers who did not have consistent employment and thus lower credit scores. Loan-to-value (LTVs) ratio is the name given to the proportion of the down payment paid in relation to the cost of a house. Traditional mortgages, pre-bubble, had required 20 percent down, which meant that they held LTVs of 80. Low LTVs were considered much safer contracts, however high LTVs made housing more affordable by eliminating large, if any, down payments from the home owning process. The average LTV of subprime loans issued in 2006 was 95, meaning, that homebuyers only had to put down 5 percent. By that time, high LTV loans had also extended to Alt-A borrowers, who were borrowers who had slightly better than subprime credit scores but were slightly under the criteria for “prime” loans or whose income or assets were under-documented. In 2006, the average Alt-A LTV was 89.⁶²

In the year 2000, the Department of Housing and Urban Development mandated that the GSEs’ low-income goals reach 50%. In response, Fannie Mae began its “American Dream Commitment” program which would span ten-years and offer roughly \$2 billion dollar in aid to first time homebuyers. Freddie Mac launched its “Catch the Dream” initiative two years later that was started to fulfill a similar goal. In 2004, HUD increased the GSEs’ goals to 56% and by 2006, 40% of all subprime loans were eventually guaranteed by GSEs.⁶³

The problem then, was in 2006 when housing prices and values began a rapid decline and mortgage payments began to increase due to teaser introductory rate periods

ending. Subprime mortgage holders began defaulting on their homes at much higher than anticipated rates and by September 2008, Fannie Mae and Freddie Mac were bailed out by the government. A week later, Lehman Brothers declared insolvency and it, too, had financed a substantial amount of consumer debt, including housing, and the perceived irresponsibility of Lehman's practices made it an unworthy candidate for a rescue.⁶⁴

How the Housing Crisis turned into the Financial Crisis

While MBS were the securities that were issued by GSEs, private investment firms such as Lehman Brothers, replicated GSE securitization and their MBS were called private-label MBS (PLMBS).⁶⁵ The primary difference between an MBS and a PLMBS is that the former had the backing of the United States government while the latter did not. By January of 2007, the cost of insuring PLMBS had risen to the point where doubts were being raised about the inherent risk of financing them. Due to the uncertainty surrounding the value of MBS, banks stagnated their lending in case they needed the reserves to pay depositors. This caused commercial banks to slow their lending to businesses. This decline in lending is what is generally considered to be the cause of the greater financial crisis, herein called the Great Recession.⁶⁶

The attraction of these bonds for investors is initially obvious due to the rapid appreciation of housing. As the price of a house increases, the LTV ratio decreases. For instance, a 20 percent down mortgage which has an LTV of 80 could go down to 73 without any principal payments by the mortgagor if the price of their home increased by ten percent because the value (V) increases while the loan (L) remains constant. Inversely, an LTV of 100 (meaning no down payment) would be pushed down to 80 LTV if there was a 25% increase in the price of the home. Thus, merely riding the boom through ensured a payout on investment even without any larger down payments.

Retrospectively, it is easy to see the risk involved with relying on housing prices to increase and thus superficially reduce the risk on subprime mortgages. In the fervor of the housing boom, however, when prices seemed as if they would only ever increase, this risk seemed negligible. Both bankers and mortgagors were so sure that housing would only appreciate, in fact, that second mortgages were issued in the form of home-equity loans, home equity lines of credit, and “cash-out refinancing” which all increased the mortgages of the houses which acted as collateral. These mechanisms, however, could only be used if the prices of homes rose proportionately, which of course, they were expected to.

Some believe that the cause of the Crisis was a lack of liquidity, meaning that banks stopped lending due to the fact that they simply did not have the cash on hand. Banks stopped interbank lending not because they did not have the cash on hand, it was because each bank feared that any potential borrower wouldn't be able to pay back the interbank loan. Due to the uncertainty regarding which banks held which assets, specifically which banks were holding subprime mortgages-backed assets, and the uncertainty surrounding how toxic these assets would actually turn out to be, the glut in lending then, resulted from wild uncertainty in the banking industry, not a lack of capital of individual banks.

The worry that commercial banks held regarding their competitors' solvency mirrored the fear that they had for their own solvency. Because holdings of MBS had uncertain value, banks could not be sure of their own risk, much less the risk that other banks faced, even the ones to which they had lent money. The world's commercial banks had made up about half of all investments in PLMBS, as well as more than \$852 billion in agency MBS.⁶⁷ The decline in the value of these securities forced banks to contract

their lending into the “real economy” of consumers starting in mid-2007.⁶⁸ The economy relies on commercial banks to lend to consumers and businesses, which for this discussion’s sake also specifically focuses on homebuyers. Thus, the prosperity of the commercial banks has a much more direct impact on the “real economy” than does that of investment banks, which underwrite bond and stock offering for large corporations. The severe contraction of lending is how the mortgage crisis turning into the financial crisis.⁶⁹

The Basel Accords, Capital Requirements, and Liabilities

The reason why commercial banks bought so many MBS is due to provisions laid out in the Basel Accords. The first Basel Accord, reached in 1988, was adopted by over 100 countries including the United States in 1991. According to the Basel I Accords, a commercial bank is considered adequately capitalized if it can fund at least eight percent of its assets with “capital.” Capital acts as a buffer or margin of error against potential losses and is money that the bank does not owe to anyone else; essentially, all money that is not debt. The point of contention here, is that most of a bank’s money is debt, money that it owes creditors as well as depositors, business, and other banks it may have borrowed from. Capital is the money a bank would have left over if the bank were to repay all of its collective debts.⁷⁰

One of the most important sources of capital for a bank is equity, the earnings and funds a bank receives from selling shares of itself to the public. Any money gained from selling stock is the bank’s money, and it is free to do with it what it pleases, as long as it remains solvent. Banks, being in the business of making profits, usually employ their capital along with money it borrows from depositors and bond holders, to make loans, of which the most salient to this discussion are mortgages, and investments such as MBS.

The loans and investments are considered “assets” due to the fact that they own them and are expected to pay the bank back some sort of return, for instance, interest and principle payments on a MBS.⁷¹

Any liabilities that are owed by the bank to its creditors are fixed and must be paid back in full. The assets the bank holds, however, usually fluctuate. Some mortgages may default or some investments may not pay out as much as was anticipated, this is why a bank keeps capital on hand, in order to pay back its debts if called upon to do so, even if it has not made enough through its assets, it has reserves. If a bank’s assets directly match the amount of liabilities it holds, any slight decline in the bank’s assets will lead it to insolvency. A bank’s capital is thusly an imperative margin of error in shielding a bank against that risk.⁷²

Another way in which a bank can come up with capital is reserving some of its earnings as “loan-loss reserve” funds. Under the Basel Accords I, loan-loss reserves are capped at 1.25 percent of a bank’s assets.⁷³ The result, in brief, is that the bank is thereby protected against *expected* losses. What happened during the Crisis was a series of large-scale *unpredicted* losses. Thus, the limitations set forth in the Basel Accords meant that banks were not fully prepared for any unexpected losses.⁷⁴

In 1999, the Securities and Exchange Commission penalized Sun Trust for holding on to too much capital. Since then, banks have been trepid of retaining too much capital for the fear of fines and penalties and of course, not earning profits. According to the Basel Accords, individual or “whole” mortgages were given a risk assessment of 50% and thus, banks were mandated to allocate \$4 of capital for every \$100 in mortgages it originated. The Basel Accords also assigned a risk weight of 20% to securities issued by “public sector” entities, which in the case of the United States meant GSEs. If a bank

were to buy \$100 of those securities, then they would only have to allot \$1.60 for capital. What ended up happening was that banks would originate mortgages, sell them to GSEs for securitization, and then buy it back as part of an agency MBS which came with the lower capital requirement. This exercise of regulatory arbitrage reduced any bank's need for scarce capital by 60 percent which meant that for whatever reason, if enough depositors demanded their savings from an institution, the bank would reach insolvency due to the fact that it did not have enough cash on hand to pay back its debts.⁷⁵

As noted previously, GSE's were not allowed to securitize subprime whole mortgages. Investment banks, however, could buy subprime mortgages from commercial banks and mortgage specialists, securitize them, and then sell the shares in the resulting PLMBS to the GSEs for their own investments. These investments helped the GSEs fulfill their mandates from HUD, and by April 2008, the GSEs held \$308 billion worth of PLMBS, making them the second largest holder of such assets, the first being commercial banks, who collectively held \$473 billion. The availability of this transfer of risk as well as the securitization and insurance that the GSEs provided created further incentive for banks to purchase mortgages as well as originate them. What this meant was that banks would then start to offer mortgages to more people, however, once "prime" borrowers had been saturated, it was then time to reduce standards and offer mortgages to "subprime" borrowers.⁷⁶

Where we are now

It is imperative to remember that the encouragements of subprime loans and increased lending were born out of public policy goals and an initiative to create widespread homeownership. The fact that homeownership is closely tied with the American identity meant that the government did whatever it could to promote any type

of economic program in order to reach its ideological goals. While that seems fairly obvious, what was not obvious was the fact that the transition from ideology to economic implementation is not seamless, and has been to a very large degree, problematic.

Chapter 3: Property Rights at the Founding

When examining property ownership in the United States and its historical significance throughout American history, it is imperative to examine the rights to property and ownership at the Founding. The American Revolution came about largely due to various violations of property rights and ownership and the ways in which the Framers constructed Founding documents, namely the Declaration of Independence and the Constitution, reflected the importance that private property played in preserving liberty and freedom.⁷⁷

Starting in 1765, Colonists began resisting British Governance due to the Crown's new taxation policies. As the taxes continued and increased, political disobedience grew more outright and the demand for change became more pronounced. The tensions escalated, and larger protests occurred such as the Boston Tea Party in 1773. With the Coercive Acts that followed as retribution, mounting pressure eventually led to the drafting of the Declaration of Independence where leading Patriots gathered to officially affirm their status as an autonomous nation. With that proclamation, the thirteen colonies became the thirteen states of the United States of America, allied under the Articles of Confederation.⁷⁸

With the signing of the Treaty of Paris in 1783, the American Revolutionary War ended, however, the injustices that the Patriots had fought against still remained.⁷⁹ Debtor relief laws as well as other property rights violations were commonplace, this time at the behest of the state legislatures. In *Vices of the Political System of the United States*, James Madison wrote that all civilizations are divided into factions, two being debtors and creditors.⁸⁰ Throughout the new states, debtor relief laws were rampant. These were egregious violations of property rights in that debts that were owed were forgiven; private

property that was owed was allowed to remain unreturned. Loans that were issued were left unpaid, and in the case of Rhode Island, the state itself printed money in order to pay off debts.⁸¹ All of this was allowed under the individual states' laws, and often contradicted the laws of the other states in the Confederation. By the year 1787, it was evident that there was a growing need for a stronger, more cohesive governance code and the Second Constitutional Congress was assembled.⁸²

Great debates between those who wanted a stronger, centralized government (Federalists), and those who wanted stronger state governments and a weaker centralized government (Anti-Federalists) took place. The Federalist view-point prevailed, but not without the admission of the Bill of Rights, an Anti-Federalist addition.⁸³

When trying to discern the reasons why property continues to play such an integral role in the American identity, it is necessary to examine the ways in which property was defined as well as the importance it played in the foundations of the nation. The Revolution, and thus, the United States, came about only through the political unrest that resulted in systemic violations of property rights, thus, the protection of those rights ended up becoming the basis for American society.

The American cultural fixation on property and ownership hold its establishment at the Founding, and looking at the philosophies of the writers of the Founding documents is imperative in tracing back the origins of American property ownership and its pursuit in American political thought and culture.

Thomas Jefferson

“If man in the state of nature be so free, as has been said; if he be absolute lord of his own person and possessions, equal to the greatest, and subject to no body, why will he part with his freedom? Why will he give up this empire, and subject himself to the

*dominion and control of any other power? ...and it is not without reason, that he seeks out, and is willing to join in society with others, who are already united, or have a mind to unite, for the mutual preservation of their lives, liberties and estates, which I call by the general name, property.” –John Locke, *The Second Treatise of Government*⁸⁴*

“We hold these truths to be self-evident, that all men are created equal, that they are endowed by their Creator with certain unalienable Rights, that among these are Life, Liberty and the pursuit of Happiness.” –The Declaration of Independence⁸⁵

Thomas Jefferson was a man of property as well as an avid espouser of Enlightenment ideology. Owning a considerable amount of property himself in the form of Virginia farm land as well as slaves, he remains one of the greatest theorists on the subject of human liberty. The primary offense that the American revolutionaries had regarding the power of the King was an overt violation of their natural rights. The Rights of Englishmen or what many called natural rights, were violated in a variety of ways including the seizure of private property without proper representation. The primary goal, then, of the Revolution was a preservation and restoration of these so-called natural rights.⁸⁶

It should be noted that this preservation of longstanding rights as well as the restoration of certain privileges did, in no way, entail, at least in theory, a complete overhaul of property rights or the construction of systemic redistribution of property. The leaders of the Revolution, property owners and intellectuals in their own right, sought to maintain their status and protect the means by which men could obtain property, but did not ascribe to the reallocation of property. Due to the violations of private property that occurred during the Revolution, particularly in the form of the Intolerable Acts, the Quartering Acts, and taxation acts which solicited new and ever-increasing duties on the

Colonies, the protection of property became one of, if not the primary, goal of the Revolution.⁸⁷

The Enlightenment philosopher, John Locke, too, wrote his *First* and *Second Treatise* to express his grievances against the English Crown, and its appropriation of property in the form of taxes. He discussed the natural rights of men, and insisted that men have a natural right to the land, a right which does not require the explicit consent of others and is granted by the laws of reason. Locke viewed the ownership of private property as antecedent to government, and indeed, the only purpose of government was to protect the rights that men hold over their property. Society then, did not need government except for the protection of rights, however, men would continue to possess their property even without the existence of government.⁸⁸

This division between government and society made possible limited revolutions, revolutions that would affect only the status and structure of government, not society. The dissolution of government would not mean the dissolution of society. Thus, Jefferson, and many of his compatriots, believed that they could overhaul the Colonies' governance system and put in place a new one, without a complete restructure of society as a whole.

Property did not just refer to the possession over one's body and labor but referred additionally to the rights, both personal and political, of individuals. Physical property was meant to affirm the natural liberties of men by providing autonomy and tools for independent economic development. Given this definition of property, when Locke philosophized that property was the end goal of government, he was stating that the end goal of government should be the protection of rights and liberties, not just property in the physical sense. The protection of property is pre-political, a natural institution given

to man from God and that ownership gives the owner absolute control over something which no one, even, and especially the state, can violate.

Jefferson's ideology can be most obviously seen in the crafting of the *Declaration of Independence* where he rewrote Locke's premise and created a phrase that is possibly one of the most famous in the American mythology, that is, "...life, liberty and the pursuit of happiness."⁸⁹ The origins of this quote would not be lost on the fellow signatories of the *Declaration*, nor its intended audience. The rhetorical symmetries between Locke's verse and Jefferson's phrase would resonate with the document's intended audience and indeed, the clarity of the purpose of the statement would transcend the adaptation. While Jefferson wrote "happiness," which some scholars argue was Jefferson's ultimate meaning, that fulfillment could only be attained through the pursuit of property due to the economic and political liberties associate with it. While a state of happiness might be a psychological one, in Jefferson's view, whatever happiness might mean could not be achieved without the attainment of property, thus, the need to explicitly state property as a goal of government and society would be unnecessary since it was understood that if happiness was a goal, so then would property be.⁹⁰ Thus, although Jefferson did not use Locke's statement verbatim, there was a clear rhetorical linkage that indicated that the protection of property was to be enforced. The statement stands in perpetuity as a promise to protect property, in its many forms, and as a goal for the newly founded American Republic.

Jefferson, like most of his other colleagues, did not value property for property's own sake. He valued it for its political meaning, to serve as a barrier between a democratic government and its people. To that effect, he made clear, in his work and writings concerning Virginian law before the Revolution, that society would be better off

with a wider distribution of property and worked to make legal the allowances that every male of appropriate age be entitled to 50 acres of land to be in his in “full and absolute dominion, and no other person shall be capable of taking an appropriation.”⁹¹ To add to the broader distribution of wealth, he included that the tradition of primogeniture, where the rights of inheritance are given to the first born male, be abolished and that females be entitled to the same inheritance rights as their male counterparts. Additionally, he believed that the abolition of engrossment and entails should occur. Such aggregation of large parcels of land was unsuitable for Virginia since it tended to create a privileged class that by the perpetuation of its own wealth, created an aristocracy which is dangerous to society.⁹²

Instead, in Jefferson’s view, there should be an aristocracy of virtue and talent, “which nature has wisely proved for the direction of the interests of society, & scattered with equal hand through all its conditions, was deemed essential to a well ordered republic.” The allowance for broader property ownership was an imperative, then, for a well-structured society. Jefferson sought to create, “a system by which every fibre would be eradicated of ancient of culture aristocracy and a foundation laid for a government truly republican.”⁹³

Additionally, Jefferson believed that immigrants to the State of Virginia should have rights to land that they themselves could cultivate and that the lands west of the Virginia Mountains be sold in small parcels and governance be organized on a republican basis. Locke’s only limit to private property was that there must be enough and as good left for others and that no one can take more than he can use.⁹⁴ Jefferson never believed this to be a realistic problem for the State, and later for the nation, due to the Continent’s vastly unpopulated (save for the Native Americans) lands and virgin territories. The idea

of allocating 50-acre parcels to all men of legal age as well as all immigrants was realistic due to the sheer amount of territory left to be aggregated. These beliefs lay behind the Northwest Ordinance, the Louisiana Purchase, and the Homesteading initiatives of the 1860s.⁹⁵ In a letter from France in 1785, Jefferson attributed vast European poverty to the fact that the nobility had enclosed large tracts of land and withdrawn them from production. Jefferson believed that the best way to avoid such an occurrence in the Colonies was to create a wider distribution of property ownership.⁹⁶

It should be noted that there is a difference between Jefferson's goals of wider property ownership and his distaste for systemic redistribution of land. He, along with Federalist's and Anti-Federalists alike believed in the protection of the rights to pursue property and its ownership, and worked extensively to create boundaries for government intervention. Redistribution entails taking from those who have private property and giving it to those who do not. Jefferson was wholly against this type of scheme, and should be distinguished from his actual ideology.⁹⁷

The view that Jefferson held about property ownership was also specific about the types of land owners that should be prevalent in the American schematic. Like Adam Smith, Jefferson placed importance in the types of owners that would use land in what he believed was the best way. As Adam Smith believed that the best owners were those who create land usages with optimal utility, Jefferson believed that the best land owners were those who productively used the land, and at the time, that was generally those of agriculture. He said of farmers that, "those who labour the earth are the chosen people of God, if ever had had a chosen people, whose breasts he has made his peculiar deposit for substantial and genuine virtue."⁹⁸

To John Jay he wrote that, “cultivators of the earth are the most valuable citizens. They are the most vigorous, the most independent, the most virtuous, and they are tied to their country and wedded to its liberty and interest by the most lasting bonds. As long therefore as they can find employment in this line, I would not convert them to mariners, artisans, or anything else.”⁹⁹ Where Smith valued utility, Jefferson saw the importance of virtuous citizenry. In Jefferson’s view, only by independent labor could a man divorce himself of his subordination to others.¹⁰⁰

When putting forth ideas for a Legislative branch, Jefferson believed that there should be two qualifications for service in the upper house: to be wise and to be “perfectly independent” however, he did not believe it necessary to require that Senators own property.¹⁰¹ In general, he believed that the decisions of the people, in a body, would be more honest and disinterested than those of wealthy men. Whoever lives in a country must wish that country well and has a natural right of assisting in the preservation of it. Jefferson believed that one could not reasonably distinguish between such a person who lived in the country, having no fixed property, and one living in a township who does.¹⁰²

Government, according to Jefferson should only have limited powers. Ideally those only to protect the divinely given rights of men, namely the protection of private property and the pursuit of it. Jefferson believed that the state should exercise no more power than the minimum authority needed to maintain social order.¹⁰³

James Madison

“The first object of government was the protection of different and unequal faculties of acquiring property”—James Madison, *The Federalist No. 10*¹⁰⁴

In the late 1780s, there was a growing sentiment amongst the leaders of the Revolution, those who had led and fought in the war as well as drafted the *Declaration* that there was an increasing need to create another binding document to replace the Articles of Confederation. In the debates that took place during the Second Continental Congress, the ideology of Federalism clearly won, however, not without variation amongst its advocates.¹⁰⁵

The primary goals that bound all of the revolutionaries together during the war had been that men had the right to be bound by laws only to which they had consented. The idea of “No taxation without representation” became a popular vocalization of that sentiment.

The idea of consent extended to property as well, with the notion that man was a slave if his property could be taken away without his consent. Due to the grievances of the British Crown during the Revolution, and then state legislature and governments during the period of the Articles of Confederation, there was a realization that property could also be threatened by a democratically elected government as well.

Madison believed that good government must be able to protect the rights of people as well as the rights of property, and clearly distinguished the two. Madison held the view that if political rights were granted to all people equally, then, the rights of people and the rights of property would not be equally protected. Thus, one set of rights had to take primacy in the framing of the Constitution. For Madison, the choice was clear: the rights of property were the most important rights because once the preservation of property was ensured, then only would all other rights be able to follow. Property was also imperative to the fledgling republic in that it preserved not just political but economic stability as well.¹⁰⁶

Madison believed that the reason why one set of rights had to take precedent ahead of the other set was not over theoretical nor moral grounds. He believed that ensuring both sets of rights would be practically difficult. He foresaw that the United States would eventually be divided between the rich and the poor, and that the poor would be a majority that was without property. Since the poor would be both the majority as well as without property, they would be disinterested in protecting the rights to property, and in fact, would be interested in violating those rights. Due to the political power as well as economic advantages that property brings, it is, per human nature, natural for those without to covet that which they do not possess. Thus, the majority would have a vested interest in violating the rights of the minority. Since those particular rights are the natural rights of men, then it is the government's objective to protect those rights. Due to the fact that the protection of property was to be the end goal of government, it followed then that any governmental system would need to protect against a tyranny of a propertyless majority. In Madison's view, people then posed a threat to the rights of property which by extension threatened political and economic stability.¹⁰⁷

This also brings to the front the discussion of suffrage. Per Madison, "men cannot be justly bound by laws in making of which they have no part."¹⁰⁸ Thus, men have a fundamental right to suffrage. If the rights to suffrage, however, were extended to all, then, the controlling power in government would belong to the propertyless majority, which, as discussed, would have no interest in the preservation of property rights. Madison believed that the rights to property superseded the individual rights of people, and thus the preservation of property would have to exist at the cost of universal suffrage. Thus, suffrage could only be granted to those who would be interested in preserving the rights to property, namely the propertied, otherwise called, Freeholders.¹⁰⁹

In principle, there is not a conflict between the rights of people and the rights of property and suffrage was a right to be universally granted. In practice, however, if political rights were given equally to all, then the rights of people and the rights of property would be unequally protected, with property rights being violated most egregiously.

In terms of representation, Madison believed that the lower house, the House of Representatives, should be duly elected by the people and represent the rights of the people, while the upper house, the Senate, would be represented by the propertied, thus protecting the rights of property. The election of the President would be open to a “qualified part” of the populace, namely, Freeholders.¹¹⁰ Madison said, “In general view, I see no reason why the rights of property which chiefly bears the burden of government and is so much an object of legislation should not be represented as well as personal rights in the choice of rulers”.¹¹¹ Essentially, the propertied have the most at stake in the well-being of the government and nation, thus, should be given the most opportunity and advocacy in government.

Unlike Jefferson, who believed that those who were to govern merely needed to be wise and perfectly independent but did not deem property ownership as a prerequisite, Madison saw a clear tie between property ownership and the qualifications for membership in government. Creating laws required the acumen of a “few select and skillful individuals” and that there were advantages of “learned institutions” in that they, “multiply the educated individuals from among whom the people may elect a due portion of their public Agents of every description; more especially of those who are to frame the laws.”¹¹² Looking at the rhetoric employed, from Madison’s perspective, the individuals

that were best suited to govern were those who were associated with property ownership, namely, those who had the means to attend such “learned institutions.”¹¹³

The wealth that came from property gave advantages to those who owned, namely the means to educate oneself on the virtues of good government. Additionally, given the suffrage rights, property owners would duly select other property owners to represent them, due to the alignment of their interests. Madison stated that the best representatives would be, “Men of intelligence, patriotism, property and independent circumstances.”¹¹⁴ Clearly then it would not just be men of property, but an elite class that would be charged with governance. Due to this unofficial prerequisite, it would remain immensely difficult for the propertyless to be elected, even if they met the constitutional requirements to hold public office.

The importance of property lay in its historical meaning as well as its theoretical. The British Crown as well as state legislatures under the Articles of Confederation had violated the rights of property through unjust taxation, the depreciation of paper money, and debtor relief laws. Unlike Locke, Madison did not use the term property to stand for all individual rights.¹¹⁵ Property for Madison did not incorporate or symbolize all individual rights, but the protection of property rights in a republic was a part of the general challenge of private rights. Property, however, did not have as narrow a definition to limit it to tangible, physical property. In the Madisonian concept, the term “property” included the free exercise of faculties for acquisition.¹¹⁶

The protection then of property meant the protection of its acquisition as well, however, this did not mean that the government was responsible for equitable acquisition. In a 1792 article, Madison wrote that it was the government’s view to protect the “different and unequal faculties of acquiring property” meaning that the goal of

government was not to ensure an equitable distribution of private property but to guarantee the equitable protection of acquisition and possession of property. Thus, the protection of liberty was the protection of possession, even if it was unequal.¹¹⁷

If a government could not protect property, people would turn to forms of other government, namely, non-republican forms of government, that would. Thus, republican government was tied to the protection of property. Property, therefore, became the paradigmatic issue of republican success. A failure of republicanism in the United States would mean the defeat of republicanism everywhere.¹¹⁸

Jefferson's and Madison's ideologies differ primarily on the subject of the spread of property ownership. As noted earlier, Jefferson wholly believed in the wider spread of property ownership and went to great pains to alter Virginian law to reflect those ideals. Madison, however, did not seem to view the spread of property as imperative to the moral integrity of government. In a letter, Jefferson wrote,

I am conscious that an equal division of property is impracticable. But the consequences of this enormous inequality producing so much misery to the bulk of mankind, legislators cannot invent too many devices for subdividing property, only taking care to let their subdivisions go hand in hand with the natural affections of the human mind. The descent of property of every kind therefore to all the children, or to all the brothers and sisters, or other relations in equal degree is a politic measure, and a practicable one... Whenever there is in any country, uncultivated lands and unemployed poor, it is clear that the laws of property have been so far extended as to violate natural right. The earth is given as a common stock for man to labour and live on. If, for the encouragement of industry we allow it to be appropriated, we must take care that other employment be furnished to those excluded from the appropriation. If we do not the fundamental right to labour the earth returns to the unemployed.¹¹⁹

Jefferson believed that the use of land carried with it a responsibility to cultivate it and use it meaningfully. The rights of property were contingent upon the fulfillment of that obligation. Madison was not fearful of concentrated ownership of land, and viewed such unequal ownership as a part of the protection of the equal exercise of the faculties of

men. The “rules of justice” demanded the protection of equal exercise, which if freely entertained, meant that due to the inequality in the faculties of men, the unequal acquisition of property would occur. The suffering of the poor, or the propertyless, was not evidence that property should be redistributed nor warranted a governmental intervention to change property allocation. Madison believed that since there was an inevitable propertyless majority, its need not be taken into account. Madison also believed that a robust economy would minimize poverty so the very poor of which Jefferson spoke would be minimal. The only object that the government should guarantee for the propertyless is a thriving economy.

Gouverneur Morris

One of Madison’s allies at the Constitutional Convention, and a student of political economy, Morris advocated for the constitutional protection of property rights as a means for preserving the nation as a market economy. In Morris’ view, life and liberty were not the reason why men came together to form society. It was for the mutual protection of property that men gave up greater freedom allowed in the State of Nature and acquiesced themselves to the confines of government and society. Property was then the only reason for men to submit themselves to the will of others. It also served as the source for all benefits of society, namely wealth and economic independence.¹²⁰

In the name of furthering economic development, the rights to property should be duly protected for if there are not protections against the unjust obtainment of another’s labor or the product of one’s labor, then there will be no incentive to labor. To that effect, Morris stated,

Unless the rewards of industry are secure, no one will be industrious; for the motive which prompts the toils of a laborious man, is the hope of enjoying what those toils produce. This produce is wealth, and whether it be in one shape or

another, so long as it is employed for the purpose of increasing the commodities in a country is it beneficial and no longer.¹²¹

Thus, Morris' primacy of property rights lay completely within the realms of economics and in the interest of protecting market economy practices.

Like Jefferson, Morris believed in the productive use of property and warned against the concentration of property ownership. He, like Jefferson, believed that there was a limit to the amount of land owners could obtain and use with utility: "A monopoly of the soil is pernicious or even destructive to society, let taxes, therefore, compel the owner, either to cultivate it himself or sell it to those who will cultivate it."¹²² Here Morris believed in using taxes, an economic vehicle, to indicate the optimal amount of land to be held by each owner, and due to unequal faculties, the optimal amount of land to be used with the most utility varied among owners.

In terms of representation, Morris agreed with Madison's view that the House of Representative was to be for the people and the Senate was to be held by the aristocracy to protect the rights to property. His reasoning for having the propertied wealthy in an isolated chamber, however, differed from Madison's. Instead, Morris argued that the people should put the "tyrannical rich" in public view in the Senate.¹²³ Only then would the populace be able to see that their own interests were not aligned with those of the rich, and then they will be duly isolated.

Morris also believed that the optimal voters were Freeholders. He argued that if the right to vote were granted to the economically dependent they would then sell their votes or would be easily swayed by the more educated. Additionally, property not only allowed for economic independence, but forced one to have a stake in the community around oneself. This, in Morris' view, would create a more engaged republic and thus the protection of property was imperative for an engaged citizenry. Property ownership

would allow people to meaningfully and responsibly participate in politics. Therefore, the only way to ensure the sanctity of suffrage was to grant it to those who were economically independent, that is, the class of the propertied.¹²⁴

Economic Framing and Political Biases

In *An Economic Interpretation of the Constitution* Charles Beard, writing in 1913, discussed the fact that the attendees of the Second Constitutional Congress were all of a particular elite class. In another work, *Framing the Constitution*, Beard points out that all of the men in attendance had some sort of formal political training and were highly educated and thus, all came from aristocratic backgrounds.¹²⁵

In *An Economic Interpretation*, Beard postulates that the Framers' Constitution is so conservative in its construct that it is actually anti-democratic, due to its exclusion of suffrage for all and serves to protect the rights of the aristocratic few. Beard further argues that the Constitution was created to solely protect one class—the wealthy—seemingly self-serving given the economic backgrounds of the participants of the Convention. Indeed, as noted earlier, the Constitution was created to protect from the tyranny of the majority, the majority being the inevitable propertyless.¹²⁶

While the House of Representatives was to be the “guardians of the poor,” the checks and balances in the system of government were in place to disallow the poor from ever aggregating enough political leverage to damage the property interests of the wealthy.¹²⁷

Beard noted that a factious nation was encouraged by Madison to prevent the occurrence of an aggregated propertyless group from amassing enough political power to incite change, or indeed, a revolution. The fears of a volatile democracy were focused on

what constant fluctuations in sentiment would mean for the economic prospects of the nation.¹²⁸

In the North, merchants and businessmen joined with the landowners of the South in their anxieties of revolution that would result in systemic redistribution of wealth, and thus, the risk of the poor from accumulating enough consensus and political power was one to be mitigated. What resulted was a systematic repression of the consideration of the well-being of the poor, and the most noted response was one given by Gouvenor Morris, and echoed by Madison, that the wellbeing of the poor would be duly addressed with the promotion of a robust economy, which could only be achieved through the protection of private property. Thus, the Framers, although diverse in their opinions on a variety of topics, were almost unanimous in their campaign to protect private property. Indeed, the conservatism of government in the pursuit of the protection of property rights is clear in the Constitution and governmental restraint prevailed for much of the next century and a half.

Conclusion

Jefferson, Madison, and Morris held different views on property ownership but none could deny its significance in preserving liberty and republican ideals. Jefferson believed that there should be widespread ownership to deter from a highly concentrated aristocracy, while Madison believed that property rights should take precedence over all other rights and that in turn ensured the preservation of property, and the preservation of republicanism would duly follow. Gouvenor Morris, with his interests vested deeply in the conservation of a market-economy, believed that property rights should be ensured to perpetuate a robust economy.

From these three leaders, it is apparent that the preservation of private property is absolute. None of the mentioned thinkers, nor indeed their most noted colleagues, believed that property should not be protected.¹²⁹ In the years that followed, judicial review solidified the barrier between the state's encroachment upon private property rights. The Civil War, which largely has its origins in the preservation of the institution of slavery, was fought due to the preservation of another type of property right. The period of homesteading in the American West was largely a tangible realization of Jeffersonian ideals as well as a means to distinguish independent, individual farming practices from those utilized in the South.

The shift in property rights came largely after the installment of President Roosevelt's New Deal plan, an economic plan to rebuff the commercial collapse brought on by the Great Depression. At that juncture, the Supreme Court began to utilize different viewpoints on property rights and the era of increased government intervention began. Most notable of these mediations was the reformation and regulation of the banking sector as well as the increased housing initiatives in the inter- and post-War eras. The conception of property morphed, but the Revolution era ideologies of equality and liberty endured and their intersection in the 1930s and onwards created a new idea of equitable property ownership, namely, homeownership.

Chapter 4: From Framers to Judges: A History of Government Intervention

Although the Framers seemed to have created an absolutist ideology concerning the preservation of property rights and the limitation of government that accompanied those protections, in the decades that followed, the practicality of government intervention and property right preservation was defined in real world experiences.

In any given society, it is the people and government of that culture that make and define property and similarly choose which types of property to protect.¹³⁰ Economic systems are often determined by what society deems as property and what is allowed to be traded, bought, and sold. Philosophers and theorists establish rules to govern society and boundaries to limit government's power; however, the enforcement of those rules and boundaries is left to posterity, and therein lies the complexity of preserving ideology. The needs of society change, and what follows is a change in the adaptations of the very rules and boundaries that govern society. This phenomenon has occurred time and time again in American history, and it is this history that explains how political thought at the nation's Founding caused the Financial Crisis.

In the previous chapter, the Founding ideologies of property protection were discussed at length and it is clear that the majority of the intellectuals who crafted Founding documents found it imperative to protect property rights, even at the expense of personal rights, which were often deemed as secondary. The reasons for why the Founders placed so much importance on property rights differ, however, the resulting framework of the Constitution is a direct result of these efforts, and the preservation of private property was given undoubtable primacy in the ensuing American tradition.

While the ideologies regarding property rights seem absolute and the framework for the government readily laid out with limitations on power, there still remained

determinations of how, in literal implementation, the government would interact with the populace and where the lines would be logistically drawn regarding the protection of private property.

In this regard, there were a myriad of political decisions made by institutions such as the Judiciary, Congress, and military elites, in the decades following the Founding that solidified exactly how government would interact with property.¹³¹ From the 1780s until the late 1920s, when the Great Depression forced the government and theorists alike to reconsider new economic paradigms, property was generally kept out of the government's reach, albeit with some remarkable exceptions. The turning point of government interaction, that is, the increase of government intervention in the realms of private property is where the foundations for the Housing Crisis and subsequent financial crisis lay, thus, it is imperative to understand not only property rights at the founding but their transcendence through time as well.

Property, conceptually, is innately complex because it derives its worth and existence largely through reciprocal relationships among people.¹³² Property serves as a physical denotation of an owner's individuality, a theme often professed by Thomas Jefferson, who viewed propertied persons as the most independent, and thus, the most ideal citizens. There are caveats to protecting private property, however, and this is the point of contention that plagued even the Founders, but that the government has since still tried to reconcile. This conflict results from the right of the majority to regulate economic activity in order to advance communal goals of the public while also protecting private property owners from others' intrusion.

The Louisiana Purchase

Scholars often refer to the two Jeffersons: one that wanted a society of small, independent farmers; and the other that believed in strict protection of property from government. These two sides of Jefferson's ideology come into conflict with the Louisiana Purchase. Due to their wartime spending, the French sold the Louisiana Territory to the United States at the onset of the 19th century. Consisting of land that now forms 15 states, the expansion of the United States under the presidency of Thomas Jefferson was a clear demonstration of the former of his two beliefs.¹³³ During his time in the Virginia State Legislature, Jefferson advocated for the rights of any male of legal age to acquire land and utilize it productively, and that it should be the State's (i.e. the government) job to ensure that right. Jefferson never reasoned that the nation would run out of land to allot, due to the vast size of the continent. From that, the Louisiana Purchase is a direct manifestation of his idea of widespread ownership. With this transaction, the government claimed nearly twice the amount of land it previously controlled, further creating the prospect of an agrarian society.

Under the Constitution as it was written, there was no provision given to the Executive that he may acquire landed property. Thus, at the time of the acquisition many accused the President of acting unconstitutionally. The Executive is, however, granted the right to negotiate treaties, and Jefferson forged ahead.¹³⁴

The issue of property rights concerning slavery arose in the territory through the presidency of James Monroe, who signed the Missouri Compromise in 1820 as a final solution to the slavery issue. The Southern representatives in Congress argued that the disallowance of slavery would prohibit the agrarian spread due to the fact that farming was largely supported by slave labor. Thus, the prohibition of slavery in those states

would have duly hindered the spread of agrarian practices, one of Jefferson's primary goals of the purchase. Northerners were wholly against the allowance, but Members of Congress needed an agreement. Thus, below the 36°30' latitude line, slavery was allowed to exist, and above it, it was outlawed. Later, due to the thousands of acres of farmable land available in the territories, it was determined that infrastructure was needed. Stephen Douglass, the Democratic Leader of the Senate, constructed a bill that allowed popular sovereignty, the right of the local citizenry to determine if slavery would be allowed in the region, to be the determinant of slave holding in those areas. What resulted was the Kansas-Nebraska Act which then caused the flooding of both abolitionist and pro-slavery campaigns into the area, particularly Kansas, exacerbating the tensions between the North and South and contributing significantly to the instigation of the Civil War.¹³⁵

This type of government intervention regarding property rights is a direct violation of the type of limited government that Jefferson and the Framers advocated so rigorously for. It was done, however, in the pursuit of propagating another Founding ideal: the creation of independent property owners. In Jefferson's view, while society is better off with protection of private property, the government has to step in to ensure widespread property rights as well, thus, the completion of the Louisiana Purchase. With Douglass, the protection of property manifested itself in the allowance of self-governance in the territories, but then allowed in many instances, for the perpetuation of slavery, an institution that largely goes against the Lockean ideals of labor and property. What these instances show is the constant contention between the protection of property, the pursuit of wider spread property ownership, and the reconciliation of Founding ideals with practicality. They also demonstrate that from the onset of the Republic, government intervention has been rationalized for the achievement of the previously mentioned goals.

The continuation of government intervention for the fulfillment of these ideals is a common trend that helps explain the modern government intervention that affect many economic practices, most notably the more recent economic crisis.

Homesteading

In the Homestead Act of 1862, President Lincoln stated that, “I am in favor of settling the wild lands into small parcels so that every poor man may have a home.”¹³⁶ The Act offered 160 acres of land, practically for free, if the tenants promised to settle and work it for five years. Lincoln’s pledge was a further vocalization and demonstration of Jefferson’s ideal agrarian society, and further evidence that the Founders’ ideals perpetuated through time. Lincoln promised land to anyone who was willing to productively cultivate it, thus producing the independent landowner that Jefferson idealized.¹³⁷

A few years following the Civil War, John Wesley Powell, the noted geologist and explorer conducted expeditions to the West and concluded in many of them that the Western territories were far too arid for agricultural development due to the amount of irrigation needed for farming. Powell served as director of the United States Geological Survey and even though his works were highly publicized and well-known for their accuracy, the West was still settled as a part of various homesteading initiatives that were created largely as a part of the ideology of the pursuit of wider property ownership and an agrarian society.¹³⁸ The United States government, regardless of scientific fact, pushed forward property initiatives that were contrary to perceived efficacy simply to fulfill goals that were established at the Founding of the nation. The phenomenon of ignoring risk and efficiency by the government for the sake of fulfillment of ideologically driven

goals is a trend that is also seen in the legislation and initiatives that caused the housing bubble and ensuing crisis.

The “Colonization of the West” has been largely seen as the conduit for the creation of true American democracy as well as the cultivation of true American identity. Frederick Jackson Turner argued that the allowance of land granted to American citizens was imperative in the creation of the modern American identity that is distinct from its European heritage. The American Frontier allowed people to separate themselves from the Eastern standards of American culture that held roots in European traditions and create a more distinctive American values in the West. This culture was one that was characterized by independent private property ownership. Perhaps the most profound take away from Turner’s thesis is that the land ownership opportunities were crucial to the American experience, so critical, in fact, that despite outright warnings of risk, property ownership initiatives were allowed to progress.¹³⁹

The Civil War, Slavery, and Reconstruction

The Founders had exhaustively declared that the right to acquire and maintain one’s own property was, undeniably, to be the prime protectorate of the government. Paradoxically, however, government, throughout American history, engaged in various policy plans to redistribute property for the sake of wider property ownership. In most cases, property reallocation was often times done in the name of the public good, for politically moral and ethical reasons such as equality and freedom, and also most importantly to protect the so called “Founding Ideology” of widespread property ownership. The contention between Jefferson’s desires for a society of property owners as well as limited government played out through the ensuing century and a half after the era of Jeffersonian Republican rule.

Some of the most egregious examples of this property reallocation occurred in the aftermath of the Civil War. The Sherman Papers, often referred to as Special Field Orders, No. 15, were issued by General William Tecumseh Sherman who was a commander of the Union Army during the Civil War. The orders declare the confiscation of 400,000 acres of land along the coasts of the states of South Carolina, Georgia, and Florida, that were to be divided into 40-acre parcels and given to 18,000 freed slave families.¹⁴⁰ This acquisition consisted of lands that had already been settled for hundreds of years, and were to be taken away from White owners and given to the recently freed persons who had worked that very land for hundreds of years. Indeed, many Freedmen felt a moral obligation to the land that they had worked for so long, and using language that parallel's Locke's in many ways, argued for their own opportunity to work and cultivate the land.

Sherman's issuances wholly typify property ownership's place in the American tradition. They are indicative of the belief that to properly assimilate people into American society, there is an aspect of property ownership that is inherent. The promise of 40-acre parcels near the coast which would have been ideal farming land and had been used for that very purpose for hundreds of years, were to give new members of society not just land, but usable land for cultivation, echoing the Jeffersonian sentiments at the Founding. While Sherman had intended for his orders to be temporary, at the time of issuance they were not taken as such by its recipients, and "40-acres and a mule" became a motto for slavery reparations as well as the idea of bestowing what is owed to those who labored so long without the realization of the fruits of those labors.¹⁴¹ Regardless, the Orders were revoked less than a year later by President Andrew Johnson.¹⁴²

With the passage of the 13th Amendment to the Constitution, the government then legalized what has been seen as the largest expropriation of property in American history. The emancipation of slaves was, in effect, the liberation of privately held property, and the 13th Amendment violates, in a way, the Fifth Amendment whereas the former slave holders were not given any compensation for their loss of property, as required.¹⁴³¹⁴⁴ That is not to say that the enslavement of persons is in anyway morally or ethically justified. Indeed, it violates many Lockean claims to private property, and the Founders were very much aware of the contention between the protection of the pursuit of property and the preservation of slavery. In his *Second Treatise*, Locke explicitly dictates that to take away the fruits of man's labor is to subject him to slavery and that slavery is the gravest of violations of man's natural rights that are granted by God, that is to say, his highest and more important rights.

While Sherman's papers were revoked by the Federal Government later on, their mere creation is an indication of government's interference with private property and reflected a growing belief in government's moral obligation to promote a healthy economy and to sustain troubled citizens. Indeed, the moral obligation to sustain a robust economy can again be traced back to the Founding, where Gouverneur Morris claimed that the end of governmental purpose should be to ensure a robust market economy, and by doing so, those of lower classes, i.e. the propertyless, will benefit.

Local governments, from the Founding, used the powers of eminent domain, the right to take private property for public use, to advance social ends at the expense of private property holders.¹⁴⁵ The Fifth Amendment of the Constitution states that, "Nor shall private property be taken for public use, without just compensation."¹⁴⁶ Through Judicial Review, however, the United States Supreme Court expanded the Federal

Government's allowances and effectively expanded the terms of "public use" to "public benefits" and "public purposes." The repercussions of this is that the Judiciary, the guardians of the Constitution and its final interpreters, incrementally allowed the government to infringe upon private property and its owners' rights for the sake of the "public good" however that may be defined.

The Civil War and Reconstruction Eras ushered in a new period in American politics where the power of the national state was allowed to expand freedom, and in the process reappropriate vast amounts of private property. The *Munn v. Illinois* verdict made "property rights one among many interests, another instrument to achieve social ends with no more constitution protection than is accorded any other."¹⁴⁷

Judicial Review

Judicial Review has been utilized throughout history as one of the primary ways policies and laws are put into action. It has often been left to the courts to decide the limits of governmental powers in relation to laws and with the issue of property rights, the courts have been instrumental in the upkeep of the boundaries on government intervention. With those decisions, however, comes the injection of personal experience and judgement on the law and gives judges independent roles in American policy. That being said, looking at the courts' rulings as well as judges' reasoning, it is clear that property rights have fluctuated over time, often in step with changing political climates and thus, shifting opinions of the courts.¹⁴⁸

The Vermont Constitution of 1791 stated that "private property ought to be subservient to public uses, when necessity requires it."¹⁴⁹ Here, it is clear that even from the very establishment of the states and the time of the Founding, the government still took allowances for compensation of land for the public good. Moreover, in the 1875

case *Kohl v United States*, the Supreme Court held that eminent domain is, “the offspring of political necessity; and it is inseparable from sovereignty.”¹⁵⁰ Eminent domain was one way that government used its power to promote a “well-ordered community” and to advance the public good and welfare through regulations that interfered with individual property rights.¹⁵¹ In 1826 Chancellor Kent wrote that,

every individual has as much freedom in the acquisition, use, and disposition of his property, as is consistent with good order and the reciprocal rights of others... Though property be thus protected...the lawgiver has a right to prescribe the mode and manner of using it, so far as may be necessary to prevent the abuse of the right, to the injury or annoyance of others or the public.¹⁵²

Kent’s remarks indicate that while individuals have the freedom to exercise their own rights of acquisition, the government also has the right to dictate the usage of private property. Justice Oliver Wendell Homes further stated that the police power of eminent domain created limits to property by other public interests, stating that, the government is within its own right to utilize property for the public good and that supersedes the private rights of individuals.¹⁵³

Massachusetts’ Chief Justice Lemuel Shaw professed one of the most definitive statements on the police power in the holding of *Commonwealth v. Alger* where he stated that,

We think it is a settled principle, growing out of the nature of well ordered civil society, that every holder of property, however absolute and unqualified may be his title, holds it under the implied liability that his use of it may be so regulated, that it shall not be injurious to the equal enjoyment of others having an equal right to the enjoyment of their property, nor injurious to the rights of the community. All property in this commonwealth, as well that in the interior as that bordering on tide waters, is derived directly or indirectly from the government, and held subject to those general regulations, which are necessary to the common good and general welfare. Rights of property, like all other social and conventional rights, are subject to such reasonable limitations in their enjoyment, as shall prevent them from being injurious, and to such reasonable restraints and regulations established by law, as the legislature, under the governing and controlling power vested in them by the constitution, may think necessary and expedient.¹⁵⁴

Justice Shaw reasoned that all holders of property are allowed their ownership with the implicit understanding that its usage is under government purview. He goes on to explain that all land is duly consequent from the government, and echoes the longstanding Lockean sentiment that there are to be reasonable limitations to rights. Similar to Locke, Justice Shaw indicates that for the good of society, an individual's enjoyment of his or her rights can be duly limited. The government, per Shaw, is then charged with creating "reasonable restraints and regulations" to ensure the preservation of the "common good and general welfare." Looking at the rhetoric that Justice Shaw utilized, the broad definition allowed for police powers to encompass a variety of uses and issues.

In an attempt to promote commerce and industry, the early 19th century state and federal governments campaigned for infrastructure development. Infrastructure development caused indirect costs and damages to the adjacent property, especially in the construction of roadways and railways. These developments also decreased the property values of the surrounding areas. The decrease in value of property rights, however, was held as subservient to the increase in public good these projects produced. Thus, the protection of private property, albeit imperative, was construed to be secondary in the promotion of the general welfare of the populace. In the case of *Charles River Bridge v Warren Bridge*, the Supreme Court held that protecting the company's property rights was secondary to the economic and social progress that would occur if the company was allowed to maintain its claim on the bridge. In the decision, Chief Justice Taney stated that if the company's rights were upheld, society would, "be thrown back to the improvements of the last century, and obliged to stand still."¹⁵⁵

In the *Heart of Atlanta Motel v. United States*, the Court found that hotel owners were obligated under the Civil Rights Act of 1964 to serve African American costumers

and that any racial discrimination was duly illegal under Title II of the Act.¹⁵⁶ This is an instance where an owner of private property was given a directive on how he or she was allowed to utilize private property and that, in fact, even if property is private, its usage could not go against public policy goals or laws set forth by the government. This government interference is a direct violation of the private property rights that the Framers instituted, however, it does align with the longstanding practice of appropriating property for the promulgation of the public's good and general welfare. What these cases demonstrate is that the problem of race is one that cannot be solved with Laissez-Faire economics. Some positive intervention is required, and the government is the entity that is charged with that necessary interference.

Constitutional scholars will reference a “constitutional revolution” in 1937, after two consecutive Justices resigned from the Court. In *Homebuilding & Loan Assoc. v. Blaisdell*, the Court held that the Minnesota law in question that extended mortgage contract obligations did not violate the Constitutional limitations on Congress. Chief Justice Hughes argued that in times of great economic emergency, there were certain allowances to be made, and government's police powers were legitimate when attempting to, “safeguard the vital interest of its people.”¹⁵⁷

In *United States v. Carolene Products Co.*, in Footnote Four, Justice Stone stated that the Court intended to defer to elected legislators in assessing economic regulations and the restrictions of property rights. Due to the fact that regulations were created for instrumental reasons, for instance, to aid an ailing economy or achieve social goals, the Court was to leave restrictions of property rights to the Legislature. In contrast, Justice Stone remarked that any intrusion of personal liberties, that is, those liberties that were

deemed secondary at the Founding to property rights, were to be examined carefully by the Court.¹⁵⁸

In the 1920s, following the stock market crash and the ensuing economic crisis, a “new breed of liberals” began promoting government regulation as a means to expedite the end of the Great Depression.¹⁵⁹ The citizenry demanded new regulations on the banks and institutions that had brought down the financial system and these new liberals acquiesced. President Franklin Roosevelt, expanding on Herbert Hoover’s previous initiatives, crafted a series of social programs that permanently changed property rights in America. The New Deal, which encompassed a wide variety of economic and social plans to “kick start” the economy as well as safeguard it, was a clear infringement upon property rights, the most substantial being the welfare programs that reappropriated property, in this case money, in the form of collected taxes, which is originally an individual’s income, and redistributed it to others. While taxes had been collected for centuries prior, the New Deal initiatives were the first wholly redistributive uses of those taxes. The Supreme Court, which had been, until this time, the guardians of property rights from government intervention, succumbed to the growing need for government interference, and moved away from its formerly absolute defense of property rights. Its reasoning was founded not on ideals that directly contradict Founding principles, but on an elaboration of them.

Gouverneur Morris, as well as James Madison advocated for a robust economy to aid the propertyless in their own prosperity. While they advocated for an undeniably limited government they also stated that it was the government’s obligation to provide a strong economy for prosperity and independent economic progress. Indeed, property ownership was seen as the means to achieve economic success and also, political and

economic independence which was imperative for a democratic republic. Since property ownership was so integral to that fulfillment and the government was charged, from its inception to provide for welfare and prosperity and a vigorous economy, political elites, in the wake of devastating depression, sought other means to fulfill those Founding goals.

Housing Initiatives in the Wake of the Great Depression

During the Great Depression, public sentiment indicated society's need to shift political approaches regarding economic practices. As mentioned earlier, due to property's intrinsic role in the economy, a shift in economic practices almost certainly results in a change in the usage or protection of private property as well. The Courts allowed the government to enact legislation that in some aspects would violate private property for some for the cause of promoting the public good. Wider spread property ownership, as per judicial review, as well as philosophical political thought is considered good for society's evolution. Ownership, as has been stated, establishes independence and thus makes for better citizens, in some cases, ideal citizens. Property ownership, particularly, owning a home, became a demarcation of upward economic mobility, and constituted the achievement of the "American Dream." Given the privileges awarded to property owners as well as the Founding ideology that idealizes a society of independent property owners, it was clear that through the American Tradition, that property ownership was an imperative in what it means to be an American.¹⁶⁰

The allowance of government to impede upon private property rights for the public good, its obligatory commitment to ensure a thriving economy for posterity, the courts' deference to the legislature to legislate as it see fit to fulfill those goals, and the focus on homeownership by the American public, culminated in housing initiatives starting in the 1930s that created the Federal National Mortgage Association (Fannie

Mae) in 1938 and the Community Reinvestment Act that caused the housing bubble and ensuing financial crisis.¹⁶¹

The National Housing Act of 1934 was enacted by Congress as a part of the New Deal. In it was created the Federal Housing Authority (FHA), the Federal Savings and Loan Insurance Corporation (FSLIC), and the United States Housing Authority (USHA). FSLIC provided deposit insurance for savings and loans institutions and USHA was created to lend money to areas for low-cost construction generally for low income members of society. The most notable contribution of the 1934 Act was the creation of the FHA which set the standards for home construction, the standards for underwriting loans, as well as their insurance for home purchasing. The FHA insured lenders against the risk of defaults on single-family homes and provided middle income families with credit so that they could buy homes with larger loans at affordable interest rates.¹⁶²

The FHA would take half of a percentage off of standard interest rates that were paid to lenders and that cost was repaid by borrowers through fees or other terms that were built into the mortgage contract. The funding received would go into a reserve fund which was held by the FHA and used to protect lenders in the case of loan defaults. Additionally, the federal government guaranteed the reserve fund in the case of a shortage, therefore, lenders that qualified for insurance under FHA standards faced no risk in lending. The FHA, however, retained the ability to dictate the standards of qualifications for the loans that were issued. These standards, however, often resulted in what is called “redlining,” a series of racially biased standards that favored White borrowers over minority borrowers, who were hindered from acquiring long-term amortized mortgages.¹⁶³ This practice contributed significantly to the segregation of neighborhoods, which was hallmarked by the unequal construction of homes. Indeed, one

of the goals of the Civil Rights movement was to achieve equal and equitable housing for African Americans. In response to the redlining and the decaying neighborhoods and blatant racism, the government enacted two Acts to increase transparency in federal lending practices: The Home Mortgage Disclosure Act (1975) and more significantly the Community Reinvestment Act (CRA) of 1977.¹⁶⁴

When examining the housing bubble, it is clear that the lending practices entertained by lenders resulted in the increase in subprime mortgages which, when they defaulted in the short amount of time that they did, caused a precipitous fall in housing prices and devastation to the economy that resulted in an economic recession and global financial crisis. Government sponsorship and policy goals as well as encouragement, and in many cases, outright mandates for loan issuances to subprime borrowers caused this crisis, and the roots of the political arguments made for the increase in homeownership are derived directly from the American Founding.

Chapter 5: Government Policies, the Bubble, and the Burst

“It means we use the mighty muscle of the federal government in combination with state and local governments to encourage owning your own home.”

—President George W. Bush, Atlanta, Georgia, May 17, 2002¹⁶⁵

There are different arguments for how and why the housing bubble and ensuing crisis occurred.¹⁶⁶ Factors ranging from monetary policy, to financial constructions, to securitization and the government’s adaptation of international policies have been posed, however, the root of the housing bubble was subprime lending, and those lending practices originated with the policies of the government sponsored entities and the demands from the Community Reinvestment Act. The ongoing political ideology of widespread property ownership drove the creation of these public policies which caused devastating effects on the national and global economy.

While many economists and analysts alike try to interpret the source of the Crisis as a failure of capitalism, what many seem to either forget or ignore is the fact that capitalism is construed and restrained by the government. Even Laissez-Faire economics constitutes minimal governmental authority. The economy is guided by policy restraints, allowing and disallowing certain practices. Thus, economic travesties, such as the most recent one, are a direct result of governmental influence.

Political initiatives are typically driven by ideology. Acts of Congress are vehicles for perpetuating these ideologies and serve as the legal manifestations of philosophical thought. When examining the roots of particular pieces of legislation, it is imperative to note their roots in American ideals and understand how they serve as the means to reach those ideals.

The creation of The Federal National Mortgage Association (Fannie Mae) and The Federal Home Loan Mortgage Corporation (Freddie Mac) as well as the

establishment and later amending of the Community Reinvestment Act are direct results of a longstanding American ideology that advocates for widespread property ownership as well as the equitable pursuit of property ownership. These two governmental actions are direct manifestations of Jefferson’s vision of a society of independent property owners albeit without the agrarian aspect, as well as Madison’s belief that the right to pursue the acquisition of property be readily protect by the government. Jefferson, Madison, and Morris probably could not conceive the mechanics of Fannie Mae and Freddie Mac or those of the Community Reinvestment Act, however, the sentiments surrounding these government initiatives is something that the Framers would have supported. The only caveat would have been that the Framers would only have supported these interventions for the sake of promoting equity in pursuit, not equity in outcome, which is what actually occurred.

The Community Reinvestment Act

“It affirms that federally insured banks and thrifts have an obligation to help meet the credit needs of the entire communities they serve, including low- and moderate-income neighborhoods, in a safe and sound manner.”

—Sandra Braunstein, Director, Division of Consumer and Community Affairs¹⁶⁷

The Community Reinvestment Act was enacted in 1977 and was designed to mandate that regulators determine if a federally insured bank was serving the needs of its entire community in the wake of racially discriminatory practices known as “redlining.”

¹⁶⁸ Any determination that banks were not serving the needs of the community meant the denial of applications for mergers and acquisitions from those banks. Thus, in order for a bank to progress and grow, it needed to demonstrate adequate community service.¹⁶⁹

For decades, however, the specifications of “serving the community” were vague and hardly ever enforced, or indeed, unenforceable due to the lack of any given criteria in the Act, save for the mentioning that banks had to serve their communities utilizing “safe and sound” lending practices.¹⁷⁰ In the wake of a study published in 1994 that appeared to indicate the continuance of racially discriminatory practices, President Clinton launched his National Homeownership Strategy led by HUD, which entailed the lowering of underwriting standards and explicitly called for new “financing strategies, fueled by the creativity and resources of the private and public sectors, to help homeowners that lack cash to buy a home or to make the payments.”¹⁷¹¹⁷² Additionally, the President also called for amendments to be made to the CRA to reflect growing sentiments of the public as well as the political elite.¹⁷³

By 1997, the new amendments were in full effect and worked to establish concrete criteria in order to determine banks’ efficacy in meeting the needs of the community and fulfilling CRA requirements. The new amendments took much of the evaluation obligations away from bank examiners and were reverted to systematic data analysis of whether very low-, low-, and moderate- income borrowers were being properly served. The new performance based assessments were thought of as a “shift of emphasis from procedural equity to equity in outcome.”¹⁷⁴

According to A.K.M. Rezaul Hossain, it was no longer, “sufficient for lenders to provide elaborate community lending efforts directed towards borrowers in the community,” instead they needed to prove that they had “an evenhanded distribution of loans across LMI and non-LMI areas and borrowers.”¹⁷⁵¹⁷⁶ It was now imperative that banks make the required loans rather than just show that they were trying to aid subprime borrowers. To help banks in the fulfillment of these goals, one of the new CRA standards

was to utilize “innovative or flexible” lending practices to address the credit needs of LMI borrowers. The vague nature of what was to constitute “innovate or flexible” was purposeful. According to Sandra Braunstein, “Neither the statute nor the agencies’ regulation specifies *how* depository institutions are to fulfill their obligation to meet the credit needs in the communities they serve.”¹⁷⁷ The government left it to the individual institutions to best decide what practices would work best for them, however, due to the fact that banks were essentially mandated to supply credit to lower income borrowers, it was almost ensured that their innovations would include some sort of relaxed standards of creditworthiness. To that effect, these new innovations and flexibilities directly resulted in relaxed lending standards, in spite of the “safe and sound” provisions of the original Act. Here, the government had a direct hand in the molding of the economic practices of financial institutions.

The most important and most perpetual consequence of the CRA amendments was the new, lower standards used in underwriting mortgages so that more people, particularly subprime borrowers, could own homes. These lower standards became the new standards for which commercial banks issued loans and the government encouragement and mandates made them commonplace lending practices that spread to the prime markets where loans were issued by lenders other than insured banks. In the time between 1995 and 2005, homeownership grew from 64 percent, where it had been for roughly 25 years, to 69 percent, the highest it has ever been, and with it came a vast increase in subprime lending practices.¹⁷⁸

Fannie Mae and Freddie Mac

“I do believe in the American Dream. I believe there is such a thing as the American Dream. And I believe those of us who have been given positions of responsibility must do

everything we can to spotlight the dream and to make sure the dream shines in all neighborhoods, all throughout our country. Owning a home is a part of that dream, it just is. Right here in America if you own your own home, you're realizing the American Dream.”

— President George W. Bush, Atlanta, Georgia, May 17, 2002, Introducing the new initiatives for Freddie Mac and Fannie Mae¹⁷⁹

As a part of the New Deal Program, President Franklin Roosevelt established Fannie Mae due to the lack of a national housing market. Before this point, Savings and Loans Associations (S&L), the primary issuers of mortgages, were not allowed to expand across state lines and thus, there was no national housing market to spread risk across. Additionally, due to the fact that the Great Depression was a crisis of credit, President Roosevelt created Fannie Mae, a government-sponsored entity to compensate for those deficiencies.¹⁸⁰ In 1968, private stockholders were allowed to buy stocks in Fannie Mae in efforts for the government to move the GSE off of its books due to its overburdened budgetary spending on the Vietnam War and entitlement programs. In order to move the expenditures off the federal budget, Fannie Mae was essentially semi-privatized. In 1970, Freddie Mac was established in order to expand the secondary housing market to further the government’s initiatives for wider spread homeownership.

The function of these two GSEs was integral in the creation of the housing bubble and subsequent collapse. Fannie Mae and Freddie Mac did not themselves lend money to homebuyers for mortgages, however, when a bank or S&L did so, Fannie and Freddie would buy that loan from the originator, thus giving the bank its money back, which subsequently allowed it to make more loans. Occasionally, the GSEs would keep the mortgages that they had bought, meaning that the fees, interests, and principle payments

on the mortgages would be received by them, but most of the time, they would package the mortgage loans, sometimes with other types of loans such as auto loans and student loans, and sell these pools to institutional investors. This subsequently gave Fannie and Freddie back *their* money to purchase more loans from mortgage originators. When the GSEs sold these packages to investors, they guaranteed that they would pay both the interest and mortgage payments if the original buyer could not. For this insurance, Fannie and Freddie charged a fee, \$100 for every \$1 million in mortgages, from which they profited immensely.¹⁸¹ These pools that Freddie and Fannie issued are the now infamous mortgage-backed securities (MBS).

In 1994 the Department of Housing and Urban Development set a requirement stating that 30 percent of all GSE mortgage purchases had to be of the affordable-housing variety. The next year, Henry Cisneros, President Clinton's Housing Secretary, set a new target for the GSEs: at least 42 percent of all mortgages that Fannie and Freddie traded had to be from low- and moderate-incomes households.¹⁸² Due to that mandate, Fannie Mae introduced a 3 percent down payment mortgage in 1997. Traditionally, the GSE mortgages had required a 20 percent down payment, however, since large down payments were one of the primary hurdles for moderate- and low-income homebuyers, the requirements for down payments were lowered in order to make mortgages more accessible.

In 1994, a HUD-sponsored study found that GSE guidelines were more likely to disqualify low-income borrowers as well as borrowers with poor credit history. This was probably due to the fact that those individuals were considered risky borrowers with higher potentials to default on their loans. Low-income borrowers are typically people who not only have lower annual incomes and personal wealth, but also those who

probably have lower savings. This means that if a low-income borrower were to lose his job, his savings might not be enough to cover his mortgage along with other expenses, forcing the mortgager to eventually default. Credit scores are an amalgamation of an individual's many financial characteristics including, but not limited to: income, job stability, and repayment of previous debts (such as credit card debt). Any of these variables can both impact and signal the likelihood of defaulting. If an individual has relative job instability, there is an obvious likelihood that he or she may not be able to pay monthly mortgage payments. If a person also exhibits the propensity for allowing credit card debt to build up and refrain from paying off debts (due to lack of funds or any other circumstance), there is also the chance that he or she might not be able to pay off a mortgage. Thus, individuals with low-income and poor credit history were considered too risky to lend to.

The findings of the 1994 study were interpreted as racially discriminatory due to that fact that borrowers with low-incomes, poor credit histories, and limited wealth tended to disproportionately belong to minority groups. In the same study, HUD found that other lenders were seen to have served low-income borrowers (due to the new CRA mandates, to be discussed later) better than the GSEs did. As per the new government imposed mandates, this was considered wholly unacceptable. Thus, Freddie and Fannie were forced to revise their strategies and began to buy loans issued to borrowers who held characteristics they would have, and previously had, rejected.

These new practices laid the foundation for accepting an increasing amount of "subprime" and "nontraditional" mortgages.¹⁸³ In the year the study was conducted, HUD found that Fannie Mae purchased mortgages with 97 LTVs, and by 2001, it was purchasing mortgages with LTVs of 100, meaning there were no down payments taken

on those mortgages at the time of origination. By 2007, the GSEs were required to show that 55 percent of their purchased mortgages were low to moderate income mortgages and that 38 percent of those needed to come from areas that were previously underserved, typically inner cities or urban fringe areas. Twenty-five percent of those loans were mandated to be from low to very-low income borrowers. From 2006-2007, Fannie and Freddie purchased roughly \$1 trillion in subprime and Alt-A loans which constituted roughly 40 percent of their total mortgage purchases.¹⁸⁴ As is apparent, from the 13 year span between 1994 and 2007, it became increasingly difficult to reconcile the goals of the Presidential administrations and HUD with creditworthiness.

Fannie and Freddie were integral in the transmission of lower lending practices in the prime market. The GSEs' holdings of these subprime loans affected the rest of the market for these mortgages by increasing the competition for the loans with private-label issuers. Before 2004, the financial advantages that the GSEs held, due to their quasi-governmental statuses which gave them access to cheaper financing, allowed them to monopolize the market that was conforming around these new securities. When the GSE's were given new directives to increase their purchasing of subprime loans, they created a higher demand for those loans which also drove up their value, reducing their risk premiums which had previously suppressed subprime origination and securitization. Due to the increase in purchasing, and the continuation of subprime lending to meet the demand for loans by the GSEs, more loans were issued to increasingly subprime borrowers. Banks and other private originator lenders such as the now-infamous and failed institution, Countrywide Financial, issued subprime loans and those loans were then pooled and bought as MBS not only by GSEs but also by private firms, such as Bear Stearns.¹⁸⁵¹⁸⁶ In the three year period from 2003 to 2006, conventional loans declined

from 78.8 percent to 59.1 percent while the subprime and Alt-A loans increased from 10.1 to 32.7 percent of all mortgages issued.¹⁸⁷¹⁸⁸

The GSE regulation-induced competition with the private-label issuers had an identical effect on the quality of mortgages that the private-label issuers were securitizing. The competition from Freddie and Fannie, beginning in 2004, caused both the GSEs and the private issuers to “bottom feed” in terms of mortgage issuances. The devolution of lending standards that were instigated with the GSEs due to their directives to meet Congress’ goals of widespread homeownership became the new norms for lending in the market.

It was clear that in the time leading up to the Crisis, and indeed, through and beyond it, the practices of limited government had eroded and in order to fulfill ideological objectives. The government interjected, threatening banks with penalties such as fines but also with denials for their own economic growth.¹⁸⁹ This type of intervention, it would seem, goes against the Founding ideals of Jefferson, Madison, and Morris, who espoused, in almost definitive terms, the restraint of government. Jefferson, however, was of two beliefs. One, that he believed in limited government, but also, that the ideal American society was to be made up of independent property owners, and that it should be the government’s job, in practice, to ensure this as much as possible.¹⁹⁰ Madison and Morris were in agreement with Jefferson’s former belief and additionally believed that the right to acquire property was at the core in protecting property rights. In the instances of both the creation of Fannie Mae and Freddie Mac, as well as the establishment of the CRA and its amendments, the manifestations of these Founding ideals directly impacted the risk- taking behavior of financial institutions, and those resulting actions,

consequences of ideologically driven policies, caused a housing bubble that imploded, and brought down the rest of the American economy with it.

From a Housing Bubble to a Financial Crisis

Housing Bubble

The origins of the housing bubble lay on the foundations of speculation and credit that flooded the market from the 1990s to the late-2000s. Freddie Mac and Fannie Mae played an integral role in the inflation of housing prices by creating high demands for lower lending standards which increased the population of homebuyers. The CRA amendments perpetuated goals of wider spread homeownership which meant that more people were allowed access to credit in order to purchase homes, adding to the increased amount of people who were eligible for property ownership.

Housing is a unique good. Its supply is difficult to manufacture quickly given the inputs required for home construction, which results in a lag in the supply of homes to meet the demand. The increase in credit and influx of viable homebuyers in the market caused demand for homes to far outstrip its supply, driving up the prices of homes (see Figure 2 where demand increases from D_1 to D_2 causing prices to increase from P_1 to P_2). The more buyers there are in a given market, the higher the prices, and thus, the larger the bubble grows. This also means that when the bubble deflates, the harder and faster prices fall. Looking at Figures 2 and 3, when demand increases for a good, for example, housing, in a basic supply and demand model, prices will increase for that good. Due to the increase in demand, suppliers, that is housing contractors and builders, will increase their production to meet the increase in demand, resulting in an increased shift in supply. This shift, as seen in Figure 3, will result in a decrease in prices once again. The higher

and faster prices climb due to increased demand which in turn is driven by an increase in credit as well as speculation, the farther they fall due to the rapid increase in supply.

Figure 2

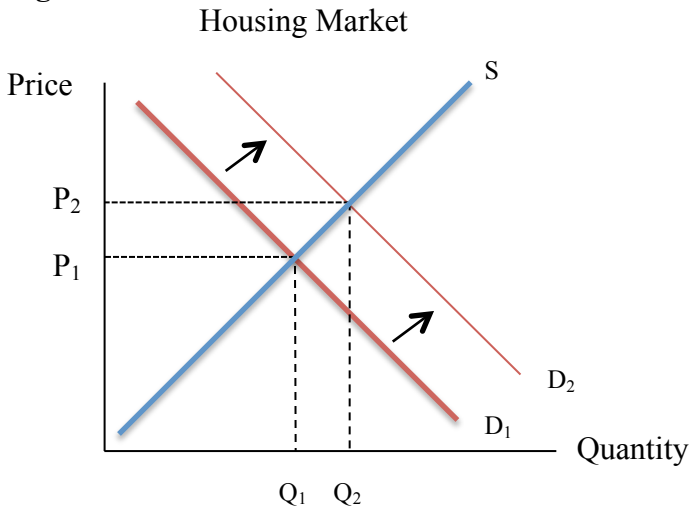


Figure 3

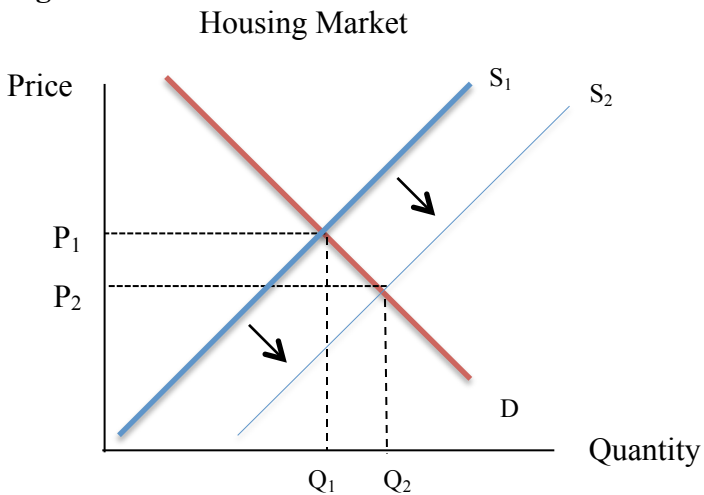
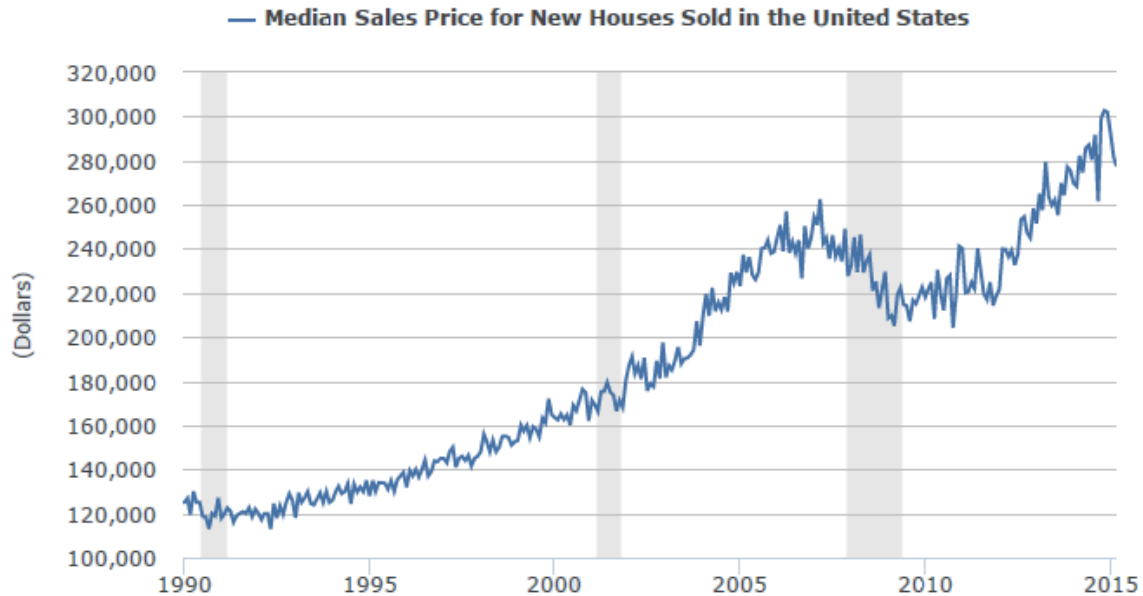


Figure 4 shows housing prices from 1990 to 2014. The shaded area on the graph, from 2007 to 2009 indicates an economic recession. The Federal Reserve Bank reported that the median housing prices in that time dropped from \$249,100 in November 2007 to \$222,300 in May 2009.¹⁹¹

Figure 4



Source: US. Bureau of the Census

Shaded areas indicate US recessions - 2015 research.stlouisfed.org

In the mortgage market, the institutions that originate mortgages are private sector lenders which include commercial banks and mortgage brokers. As mentioned earlier, Fannie Mae and Freddie Mac purchased loans issued by the lenders, thus freeing up the originator's assets so that it could issue more loans. Fannie and Freddie then packaged and sold these mortgages in the secondary market as securities. The GSEs, however, were not the only ones to engage in these securitization practices. Private investment banks also partook in the securitization, and sold shares of the future principle and interest payments to investors, both domestic and international. While GSEs pioneered the prime-mortgage securitization model, investment banks extended those models to other, riskier, assets, most notably subprime mortgages.¹⁹² When the bubble collapsed in 2008, 41 percent of all mortgages were held by GSEs and the other 59 percent were held by commercial banks of origin or private investment firms in the form of MBS.¹⁹³

Adjustable Rate Mortgages

The issuance of adjustable rate mortgages (ARMs) further made MBS risky investments. Following the burst of the tech bubble in the early 2000s, the Federal Reserve lowered interest rates in the hopes of avoiding deflation and kept them suppressed for the following five years. Prime rates soon followed and dropped from roughly 8 percent to 5.25 percent and fluctuated from 5.25 to 6 percent, the lowest they had been since the end of World War II, until 2007. While these rates contributed greatly to the increase in demand in the housing market by making borrowing and paying back loans cheaper, they would have to increase again at some point. Mortgages, however, are issued typically on a 15-year or 30-year contractual basis, thus if interest rates increased in that time, the bank of issuance stood to lose profit and that could easily lead to insolvency. This occurred due to the fact that if the federal funds rate, the rate that banks lend to each other, increased but interest rates were locked, the bank would then have to pay its depositors as well as borrow money at a higher rate than it was receiving from its mortgages. Banks would then have to borrow money and risk insolvency. To combat those possibilities, the adjustable rate mortgage was created.

Starting in 2004, ARMs were issued with low two or three year “teaser rates” that compensated the borrower for assuming the responsibility of paying higher interest rates in the future if needed. In practicality, however, borrowers who held ARMs were generally unaware of the potential increase in interest rates, and when the interest rate finally did increase, many were forced to default due to rapidly rising monthly payments.¹⁹⁴ Additionally, teaser rates could be extended if the mortgage loans were refinanced at similar rates, as long as housing prices were increasing, which for nearly a decade, they were.

Mortgages tend to be the largest financial asset and liability of any household, with a home sometimes representing 35 percent of a household's total wealth. This makes households particularly sensitive to changes in monthly payments, since a large part of their annual incomes are dedicated to paying off their mortgage. Also, given the fact that most ARMs were issued to moderate-, low-, and very low-income borrowers, household that are not typically able to save much of their after-tax incomes, and they could not afford much fluctuation in their monthly payments, so when the interest rates on homes inevitably rose again, those homeowners had no choice but to default on their loans.¹⁹⁵

Securitization

Goldman Sachs and Lehman Brother were two large issuers of private label mortgage-backed securities. Similar to the securities issued by the GSEs, PLMBS were distinct from agency MBS due to the latter's governmental guarantee. PLMBS, however, did not have any such guarantee, and thus, their risk evaluations were based on the determinations made by ratings agencies, otherwise known as the Nationally Recognized Statistical Organizations (NRSROs).¹⁹⁶

As noted earlier, the agency MBS were given the backing of the federal government, therefore, these bonds were guaranteed to their holders. The PLMBS, however, were given ratings by the now notorious Moody's, Standard and Poor's, and Fitch. These rating agencies, while renowned for their storied histories in the financial sector, were highly inaccurate in recent context for a variety of reasons. For the decades leading up to the crash, the three NRSROs failed to update their statistical models of the housing market, and indeed, never in any of their calculations, incorporated a scenario where there would be a national decrease in housing prices. The failure to incorporate any new scenarios or findings stems from a history of complacency at the agencies.¹⁹⁷

In 1975, the Securities and Exchange Commission granted the three firms government-protected oligopoly status, making it illegal for many government sponsored funds to use ratings from other sources, essentially making it impossible for any other firms to compete with the NRSROs. This led to a culture of complacency in the three agencies. Due to their storied histories of accuracy, everyone, from federal government officials to investors, took the ratings as nothing less than accurate. Thus, when the agencies rated subprime MBS as AAA (the highest possible rating), institutions invested in droves. In fact, at the time of the bubble burst, 80 percent of the MBS sold held ratings of AAA.

Why, then, was there widespread failure of financial institutions and freezing up of capital markets? If bad mortgages sold to investors were all there was to it, the deflation of the housing bubble would not have been any different than the crash of the tech bubble in the early 2000s, meaning, it would have been self-contained to that industry. Due to securitization, risk was heavily concentrated on banks, both commercial and investment, and even insurance companies that had purchased AAA rated MBS.¹⁹⁸

Due to the United States adoption of international rules, securitization was an easy work around for capital requirements.¹⁹⁹ Securitization permits banks to use less capital by allowing them to be underwriters for mortgages while also retaining their roles as originators. As mentioned before, the selling of mortgages by originating banks freed up their reserves to make more loans. They would also, however, repurchase the loans they had originated after they were securitized or they would purchase securities that were originated by other banks. Commercial banks were required to hold less capital for the MBS they acquired than for the mortgages they held, so even though they issued extensive amounts of mortgages, they were allowed to hold less than half the capital they

otherwise would have been required to due to securitization. This severely changed the very nature of banking. Now, bankers acted as intermediaries between investors and borrowers, rather than just depositors and borrowers as they previously had.²⁰⁰

Starting at the end of 2002, investment banks applied the same securitization model that the GSEs had established with prime mortgages to subprime mortgages. This allowed commercial banks to transfer their risk from their own institutions onto the market at large in the form of PLMBS.²⁰¹

When the interest rates on adjustable rate mortgages finally began their rise in 2006 and 2007, mortgagers began to default at higher-than-expected rates. Due to the fact that a vast majority of ARMs had been issued at around the same time, their interest rates began resetting at the same time as well, and by extension, subprime mortgagers began to default simultaneously.²⁰² When these borrowers began to default on these loans, the values of their homes declined at a rapid pace, and the bubble began its deflation.

It soon became clear that the mortgages that backed the securities that were traded so vastly and numerous were toxic, and that the AAA ratings were misleading regarding their risk. Investors began divesting from portfolios and institutions that were thought to have large holdings of MBS and stocks in many of the investment banks began to plummet.

On September 6, 2008, the government rescued Fannie Mae and Freddie Mac, as was expected due to their quasi-governmental status. Due to the government's guarantee of securities the GSEs issued, it alleviated one of the most potentially destructive risks of the collapse of the housing bubble: that commercial banks would collapse due to their holding of \$854 billion in agency MBS. Freddie and Fannie were "bailed out," however, private investment banks were not as fortunate, at least not initially. Countrywide

Finance, for example, was sold to Bank of America for two dollars a share. Lehman Brothers, however, the most infamous of all investment firms, was left to collapse. Its folding exacerbated the markets to the point where other investment banks, insurance firms such as the American International Group (AIG), and businesses small and large alike faced economic hardships, bringing some to the brink of bankruptcy or insolvency.

In the week following the GSE bailout, interbank lending, upon which investment banks rely heavily, nearly stopped.²⁰³ This decline was not due to a lack of liquidity, indeed, banks had the cash on hand to loan to each other. It was due to the lack of faith that each bank had in the others' ability to pay back any loans dispensed. This uncertainty stemmed from a lack of information on who was holding subprime mortgages and how toxic those securities would end up being once the market stabilized. The fear of mutual insolvency led to a crisis of lending. Lehman Brothers was one of the largest private securitizers of subprime mortgages and without the interbank loans, Lehman Brothers eventually filed for bankruptcy.²⁰⁴

In the week following Lehman's collapse, interbank lending froze everywhere, even amongst commercial banks. By fearing the solvency of each other, they needed to fear for their own solvencies as well. Commercial banks had invested largely in the subprime securities that the investment banks had securitized, in fact, in April 2008, just five months before the collapse of Freddie, Fannie, and Lehman, American commercial banks were the single largest purchasers of MBS. Due to the fact that the MBS were devaluating at a rapid pace, and there was a large deficit of information about their worth and toxicity, banks had no choice but to hold onto their cash in the event there was a run on their banks and they needed pay depositors.²⁰⁵

Commercial banks serve an integral role in the economy. These institutions are charged with lending to not only homebuyers, but also to consumers and businesses of all types of goods. Commercial banks thus have an immense impact in the “real economy” especially when compared to their investment bank counterparts, who primarily are charged with investments, but are not responsible for financing consumer credit, or loans for student education, automobiles, or businesses. Thus, when commercial banks contracted their lending, it affected the economy on a larger scale. Businesses were unable to take out loans, many homeowners lost their homes, or struggled to pay their mortgages at higher rates than they previously had to. Thus they had less money to spend on other goods, and due to the contraction in business, many firms were forced to lay off their personnel, causing unemployment to increase and also further contributed to the economic downturn. The fact that commercial banks held such a vast amount of MBS that were backed by subprime mortgages that defaulted caused the housing bubble to turn into a financial crisis that detrimentally affected the rest of the economy.²⁰⁶

The contraction of lending, however, was not unique to the United States. International commercial banks made up half of the PLMBS purchases, and the decline in the worth of those securities forced banks to halt their own lending to their own communities, all at once, all over the world.²⁰⁷

Credit Default Swaps and the American International Group

To be sure, investors were not wholly ignorant of the risk involved with the securities they were so heavily investing in. While they may not have had complete knowledge of the subprime mortgages or the fragile nature of the bubble, whenever there is any type of risk, most investors, indeed, the prudent ones, often took out insurance on

their investments. One of the most common forms of insurance during the housing bubble was credit default swap (CDS).²⁰⁸

A CDS is contract in which one party, the protection seller, agrees to reimburse another party, the protection buyer, against the default of a financial obligation by a third party, often called the reference entity or the issuer of the bond. What happens in a CDS is essentially a shifting of risk from one party to another.²⁰⁹

In the instance of MBS and CDS, investment banks and private entities alike would purchase mortgage-backed securities. In order to offset risk, these entities would then purchase insurance in the form of credit-default swaps on the chance that the underlying collateral on the MBS would default, i.e. the mortgages. The insurance provider, the seller of the CDS, would ensure that if the MBS valuation decreased, it would pay the purchaser of the insurance the amount previously agreed upon. In the meantime, the protection buyer would pay a premium to the protection seller. One of the largest issuers of CDS was AIG.²¹⁰

AIG fell to the brink of failure in the week following the demise of Lehman Brothers. AIG's models that assessed credit-risk inadequately accounted for the risk in MBS as well the possibilities for a decline in the mortgage market and a downgrade in its credit-rating from the NRSROs. Due to the fact that AIG's risk was rated AAA, the counterparties in AIG's CDS did not posit the need for AIG to post collateral to prove it could make good on its obligations. When its rating was suddenly downgraded, it was then obligated to post collateral—collateral that it did not possess. Additionally, due to the fact AIG had written protection on MBS, when they declined in valuation, AIG was forced to post collateral for its newly exposed risk as well. These two conditions combined, AIG was unable to post the newly demanded collateral, and was forced to the

brink of bankruptcy. At that point, due to the fragility of the markets following the collapse of Lehman, the trepidation surrounding other investment banks, and the insurance that AIG provided for millions of businesses outside of the financial industry, the Federal Reserve stepped in to bail out AIG.²¹¹

The Bailout

In the wake of Lehman Brothers and AIG, the Department of the Treasury announced that it would assemble and propose a rescue package aimed at eliminating the risk that commercial and investment banks held concerning the so-called “toxic” mortgage securities.²¹² On September 23, 2008, Ben Bernanke, the Chairman of the Federal Reserve, and Henry Paulsen, the Treasury Secretary, testified to the Senate Banking Committee stating their proposal would require a \$700 billion allowance to purchase assets and equity to alleviate the stress on the financial industry and subsequently strengthen it. On October 3, 2008, President Bush signed the Troubled Asset Relief Program (TARP).²¹³

The stipulations of TARP were that the Treasury Department was to purchase any assets backed by mortgages that were deemed “toxic” and issued before March 14, 2008. The purchasing included illiquid assets whose values were difficult to assess and the program itself was aimed at putting liquidity back into the market. This liquidity injection was instigated in the hopes that banks would increase their lending to the market at large as well as to each other.²¹⁴

TARP was famously written and proposed on a two-and-a-half page document, and did not propose any oversight regulations. To that effect, the fears of moral hazard were raised. Indeed, many banks did not, in fact, increase their lending practices in the

private sector as had been hoped. Banks' uncertainty in private sector borrowers to be able to pay back potential loans curbed them from issuing any such loans.²¹⁵

Conclusion

In conclusion, in order to fulfil ideologically fueled policy goals, the federal government created Freddie Mac and Fannie Mae to make mortgage lending more appealing to commercial banks and other mortgage originators. In order to do so, Fannie and Freddie pioneered a model of securitization that was later adopted in the private sector among investment banks and other entities that securitized subprime mortgages. Additionally, amendments to the Community Reinvestment Act created financial consequences for banks that were not seen as fulfilling the public policy goals of serving low- and moderate-income borrowers and by using the force of the government, directly intervened in economic activities to perpetuate ideological goals.

The subprime lending practices instigated by the GSEs as well as the CRA amendments had a direct effect on the housing market. Both the CRA amendments and the GSEs put pressure on lenders to increase the rate of homeownership in the nation by giving subprime borrowers access to credit. This increased the number of homebuyers and thus, increased the demand in homes which then forced housing prices to rise. Due to this rapid rise speculation increased that home prices would continue their rise and the mortgages upon which securities were backed were seen as sound investments. Rating agencies echoed those sentiments by providing the highest possible ratings to MBS.

Insurance taken out on MBS in the form of credit-default swaps then transferred risks from investment banks to other entities, most notably AIG, and when finally, the interest rates on the adjustable-rate mortgages began to reset, subprime mortgagors began to default, at unprecedented rates and quantities, all at once, rapidly devaluating MBS,

causing housing prices to free-fall, and due to expenditures issued in the forms of loans, the sudden lack of payment on those debts, commercial banks, GSEs, and private investors alike began losing money pressing some to insolvency and other still, to forced government takeovers and bail outs.

Chapter 6: Where Do We Go From Here

Nearly ten years after the beginning of the collapse of the housing bubble, it is clear there has been a paradigm shift in the national political economy. This shift will undoubtedly affect governance as well as economic practices for decades to come. While most economists will agree that, at the point of this writing, the economy is recovering, the Great Recession will remain stark in the national memory for years to come.

The housing initiatives that were promoted in the 1990s and 2000s have, paradoxically, hurt the people that the government initially set out to help. Subprime borrowers, the targets of the CRA, Fannie Mae, and Freddie Mac programs defaulted in the mid- to late- 2000s on their mortgages, resulting in many of those borrowers losing their homes. Homeownership rates for African Americans and Hispanics show that minorities have disproportionately lost their homes when compared to their White counterparts.²¹⁶ Retrospectively, what these government initiatives did was disadvantage many of the citizens that they originally sought to help, and worse yet, it all could have been avoided, had the government refrained from setting initiatives that compelled banks to issue riskier mortgages. The fact that the government looked to aid all citizens in their pursuit of the American Dream led, in fact, to the demolition of it for many thousands of people, not just in the form of homeownership losses, but also in unemployment and economic stress as well.²¹⁷

Looking forward, what needs to happen is a return to more responsible lending practices. There is a reason why low-income and moderate-income level borrowers were not receiving home loans from commercial banks. If these borrowers were considered safe risks to take, then banks would have taken them. As mentioned earlier, mortgages are bank assets, meaning that banks make profits off of them. Due to the CRA banks

were forced to lend to people that they would not have otherwise given loans to. But there was a reason for that, they were risky borrowers, and the banks were aware of that, but the government incentivized these subprime loans to the point that it became a necessity to make them.

It was bad public policy and even worse publicity, however, and it looked as though a disproportionate amount of people were being systemically barred from achieving the American Dream. Those people also happened to belong to a group that was systemically discriminated against throughout American history. The public outcry leading up to these initiatives was strong, and the government, due to ideology and public pressure, needed to step in and remedy the fact that homeownership rates were not equal amongst all people. What ended up happening was the economic devastation that has been discussed at length in this thesis.

What needs to occur now are more responsible lending practices, a retreat back to the “traditional mortgages” where borrowers are asked to provide a 20 percent down payment and fulfill a long-term mortgage contract. Perhaps what is needed is a shift in the length of how long the mortgage contract is. While it is hard to imagine a contract longer than 30 years, perhaps that is an avenue that banks need to explore. We also need to make sure that borrowers are made well aware of the contracts that they engage in. We need a shift back to responsible lending, but also a shift towards responsible borrowing.

In addition to the logistical practices of the financial sector, a larger, more profound change needs to occur within the American psyche. What needs to follow is a shift in the idea of what an achievement of the “American Dream” entails. Striving for upward social mobility is a noble goal, indeed, it is natural to want to better one’s position, particularly financially. What needs to change, however, is how society

qualifies that upward mobility. Instead of homeownership, or any other sort of material possession, we as a culture need to find different ways to denote an achievement of the Dream and what it truly means to be an American.

Education is in many ways, the best vehicle for upward social mobility. Higher education leads to higher wages and quality of life, and indeed, if we are ever to truly achieve Jefferson's ideal society of independent citizens and a responsible citizenry, perhaps we need to forfeit his requisite of property ownership and place more importance on the idea of independent and informed citizens. The best way to do this is by ensuring quality education to all members of our society, at least to the high school level, and work towards making universal higher education a reality.

One of the biggest issues with adjustable rate mortgages was the fact that there was a vast knowledge deficit regarding the mortgages, their terms, and financial management in general. If we are to demand that members of our society engage in homeownership, and instill the idea of homeownership as an imperative aspect of belonging to this society, then we are also duly charged with educating our population about what the responsibilities of those ideals entail. You should not have to have a degree in economics or finance to be able to interact with a bank and takeout a mortgage. What every person has a right to regarding life, liberty, and their own pursuits of happiness, is a government that ensures an education to supplement those goals. There are certainly other means of accomplishing upward social mobility other than homeownership, but education is the most feasible, given its already existing infrastructure and it is also the one with substantial positive externalities associated with it.

At the very least, most students attend school part-way through high school. In 2012, the national high school graduation rate surpassed 80 percent.²¹⁸ If basic financial management is taught in high schools and we educate students about the economic tools needed to procure loans and successfully pay them back, then we are capable of producing generations of more responsible borrowers, and more conscientious citizens. We need to make education a priority, and link it as fervently to the American Identity as homeownership has been for past generations.

The United States, throughout history, has been a storied nation of opportunity. It has been a place where people from all over the world, hailing from all nations, can come and create new lives that are full of opportunities that were disallowed to them elsewhere. Education is a right that many are denied around the world. It should not be here, and it is one of the best available resources we have. It can also act as a tool, and should. Education should be the conduit we use to provide our youth with the tools necessary to achieve their own personal happiness and attain their own American Dreams. We have already started on this new path, with free community college for students who qualify. Additionally, there has been increase in loan debt from student loans which many believe resembles the housing bubble from a decade ago. Finally, we have the DREAM Act, an act that would provide education for minors living in the United States undocumented. All three of these instances indicate that we, as a society, now view education as an imperative to American life.

Madison was a vehement advocate for the equal protection in the faculties of people to own property. By creating equitable, high quality education for our posterity, we are further protecting the rights for the equal opportunity to exercise naturally given faculties. Madison offered that this would be the best way for people to obtain property.

Adopting this postulation to modern times, the equal opportunity in exercising faculties, protected and supported by universal basic education, is the best way for us to allow future generations to accomplish and realize their own ambitions, ownership aside.

In the wake of the Crisis, we need to think about a new a way to achieve the American Dream. It simply is not good public policy nor economically feasible to continue the trajectory of imperative homeownership that this nation has been on. We have experimented with it, and it has had ruinous consequences. We need to rethink what we should idealize in society and quantify in the American Identity. It is imperative that we rethink and requalify a new American Dream.

Appendix A

Quarterly Homeownership Rates by Race and Ethnicity: 1994-2014

Year and quarter	U.S.	Non-Hispanic White Alone	Black Alone	All Other Races ¹	Hispanic (of any race)
1994					
1st.....	63.8	69.8	42.1	50.1	40.3
2nd.....	63.8	69.9	41.8	46.3	41.1
3rd.....	64.1	70.0	42.7	46.9	41.1
4th.....	64.2	70.2	42.6	47.6	42.2
1995					
1st.....	64.2	70.0	42.7	46.9	41.4
2nd.....	64.7	70.2	42.6	47.6	42.2
3rd.....	65.0	70.4	41.2	47.2	41.8
4th.....	65.1	70.9	42.2	46.7	42.8
1996					
1st.....	65.1	71.4	43.8	50.9	41.4
2nd.....	65.4	71.7	43.7	50.0	43.9
3rd.....	65.6	71.8	44.5	51.5	43.5
4th.....	65.4	71.8	44.4	51.4	42.3
1997					
1st.....	65.4	71.6	44.5	51.8	42.6
2nd.....	65.7	72.1	44.4	52.7	43.3
3rd.....	66.0	72.3	45.3	53.1	43.0
4th.....	65.7	71.9	45.1	52.5	44.0
1998					
1st.....	65.9	72.1	45.2	52.3	44.4
2nd.....	66.0	72.5	44.7	53.5	43.9
3rd.....	66.8	73.1	46.6	53.6	44.9
4th.....	66.4	72.6	45.9	52.7	45.7
1999					
1st.....	66.7	72.8	46.3	52.8	46.2
2nd.....	66.6	73.2	45.3	53.2	44.9
3rd.....	67.0	73.5	46.6	54.5	45.5
4th.....	66.9	73.3	46.8	54.3	45.5
2000					
1st.....	67.1	73.4	47.4	53.6	45.7
2nd.....	67.2	73.7	46.7	54.4	45.4

3rd.....	67.7	74.3	46.8	53.9	46.7
4th.....	67.5	73.9	47.8	52.4	47.5
2001					
1st.....	67.5	74.0	47.5	53.9	46.1
2nd.....	67.7	74.1	47.9	55.2	46.1
3rd.....	68.1	74.6	47.5	54.4	48.1
4th.....	68.0	74.4	48.1	53.2	48.8
2002\r					
1st.....	67.8	74.6	48.2	53.5	46.4
2nd.....	67.6	74.5	46.5	55.3	46.1
3rd.....	68.0	74.9	47.3	54.0	47.1
4th.....	68.3	75.0	47.7	55.2	48.3
2003					
1st.....	68.0	75.0	47.7	55.7	46.7
2nd.....	68.0	75.2	47.3	55.3	46.2
3rd.....	68.4	75.7	48.0	56.2	46.1
4th.....	68.6	75.5	49.4	56.6	47.7
2004					
1st.....	68.6	75.5	49.3	58.2	47.3
2nd.....	69.2	76.2	49.7	58.7	47.4
3rd.....	69.0	76.1	48.4	58.6	48.7
4th.....	69.2	76.2	49.1	58.9	48.9
2005					
1st.....	69.1	76.0	48.8	59.4	49.7
2nd.....	68.6	75.6	48.0	58.0	49.2
3rd.....	68.8	75.7	48.1	59.9	49.1
4th.....	69.0	76.0	48.0	60.1	50.0
2006					
1st.....	68.5	75.5	47.3	59.6	49.4
2nd.....	68.7	75.9	47.2	59.3	50.0
3rd.....	69.0	76.0	48.6	60.6	49.7
4th.....	68.9	76.0	48.2	60.0	49.5
2007					
1st.....	68.4	75.3	48.0	58.6	50.1
2nd.....	68.2	75.4	46.3	59.4	50.0
3rd.....	68.2	75.3	46.7	60.1	50.1
4th.....	67.8	74.9	47.7	58.6	48.5
2008					
1st.....	67.8	75.0	47.1	58.1	48.9

2nd.....	68.1	75.2	47.8	58.4	49.6
3rd.....	67.9	75.1	47.8	59.0	49.5
4th.....	67.5	74.8	46.8	58.3	48.6
2009					
1st.....	67.3	74.7	46.1	57.4	48.6
2nd.....	67.4	74.9	46.5	57.6	48.1
3rd.....	67.6	75.0	46.4	57.8	48.7
4th.....	67.2	74.5	46.0	58.4	48.4
2010					
1st....	67.1	74.5	45.6	57.2	48.5
2nd....	66.9	74.4	46.2	55.7	47.8
3rd....	66.9	74.7	45.0	57.3	47.0
4th.....	66.5	74.2	44.9	57.7	46.8
2011					
1st....	66.4	74.1	44.8	56.7	46.8
2nd....	65.9	73.7	44.2	56.0	46.6
3rd....	66.3	73.8	45.6	56.4	47.6
4th.....	66.0	73.7	45.1	56.5	46.6
2012					
1st....	65.4	73.5	43.1	55.1	46.3
2nd....	65.5	73.5	43.8	55.0	46.5
3rd....	65.5	73.6	44.1	54.6	46.7
4th.....	65.4	73.6	44.5	55.2	45.0
2013					
1st....	65.0	73.4	43.1	54.6	45.3
2nd....	65.0	73.3	42.9	54.5	45.9
3rd....	65.3	73.3	43.1	55.2	47.6
4th.....	65.2	73.4	43.2	56.0	45.5
2014					
1st....	64.8	72.9	43.3	55.8	45.8
2nd....	64.7	72.9	43.5	54.7	45.8
3rd....	64.4	72.6	42.9	54.2	45.6
4th.....	64.0	72.3	42.1	55.3	44.5

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- ⁹ Krueckeberg, 12
- ¹⁰ Krueckeberg, 12
- ¹¹ The Virginia Declaration of Rights, Section I
- ¹² Bush, George W., President. "Speech to HUD Employees on National Homeownership Month." Department of Housing and Urban Development, Washington, DC. 28 Oct. 2014. *Archives.hud.gov*. Web. <<http://archives.hud.gov/remarks/martinez/speeches/presremarks.cfm>>.
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- ¹⁷ Krueckeberg, 13
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- ¹⁹ Tocqueville, Alexis De. "Social Conditions of the Anglo Americans." *Democracy in America*. Cambridge: Sever and Francis, 1862. Print.
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- ²¹ Krueckeberg, 12
- ²² Krueckeberg, 12
- ²³ Krueckeberg, 15
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- ³⁰ An “amortized loans” is a loan with scheduled periodic payments of both principal and interest. This is opposed to loans with interest-only payment features, balloon payment features and even negatively amortizing payment features. ("Amortized Loan Definition | Investopedia." *Investopedia*. 14 May 2007. Web. 13 Apr. 2015. <http://www.investopedia.com/terms/a/amortized_loan.asp>.)
- ³¹ Monteyne, 2004
- ³² Monteyne, 2004
- ³³ President Harry S. Truman, Remarks when signing the Housing Act of 1949
- ³⁴ Martinez, 2000
- ³⁵ Martinez, 2000
- ³⁶ Monteyne, 2004
- ³⁷ Monteyne, 2004
- ³⁸ Monteyne, 2004
- ³⁹ Monteyne, 2004
- ⁴⁰ Monteyne, 2004
- ⁴¹ Richard Avramenko and Richard Boyd (2013). *Subprime Virtues: The Moral Dimensions of American Housing and Mortgage Policy*. *Perspectives on Politics*, 11, pp 111-131.
- ⁴² Avramenko, 112
- ⁴³ Avramenko, 112
- ⁴⁴ Avramenko, 112
- ⁴⁵ Largely an extension of President Clinton’s National Homeownership Strategy, President George W. Bush established a campaign that he stated would bring Americans closer to the achievement of the American Dream⁴⁵. President Bush’s “Ownership Society” was an initiative where, “citizens would be in control of their own lives and wealth through ownership, which would promote both independence and responsibility... it was the expression of a willingness to use the lever of government to treat ownership more favorably than other contractual relationships in the marketplace.”
- ⁴⁶ Shiller, 12
- ⁴⁷ Friedman, Jeffrey. "Capitalism and the Crisis: Bankers, Bonuses, Ideology, and Ignorance." *What Caused the Financial Crisis*. Philadelphia: U of Pennsylvania, 2011. 1-67. Print.
- ⁴⁸ Shiller, 14
- ⁴⁹ Monteyne, 2004
- ⁵⁰ Monteyne, 2004
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- ⁶⁰ Friedman, 13
- ⁶¹ Friedman, 4
- ⁶² Friedman, 4
- ⁶³ Friedman, 5
- ⁶⁴ Friedman, 5
- ⁶⁵ Friedman, 13
- ⁶⁶ Friedman, 6
- ⁶⁷ Friedman, 5
- ⁶⁸ Friedman, 19
- ⁶⁹ Friedman, 19
- ⁷⁰ Friedman, 21
- ⁷¹ Friedman, 22
- ⁷² Friedman, 22
- ⁷³ Friedman, 23
- ⁷⁴ Friedman, 23
- ⁷⁵ Friedman, 23-24
- ⁷⁶ Friedman, 25
- ⁷⁷ Stanley N. Katz. *Journal of Law and Economics*. Vol. 19, No. 3, 1776: The Revolution in Social Thought (Oct., 1976), pp. 467-488
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- ⁸⁴ Locke, John. "Second Treatise of Government." *Projectgutenberg.org*. Project Gutenberg, Jan. 2005. Web. 7 Mar. 2015.
- ⁸⁵ The Declaration of Independence
- ⁸⁶ Katz, 467
- ⁸⁷ Revolutionary War Timeline
- ⁸⁸ Katz, 470
- ⁸⁹ *The Declaration*
- ⁹⁰ Katz, 469
- ⁹¹ Katz 470
- ⁹² Katz, 471
- ⁹³ Thomas Jefferson, *Autobiography 1743-1790*, in 1 *The Works of Thomas Jefferson* 3, 58-59 (Paul Leicester Ford ed. 1904)
- ⁹⁴ Katz, 475

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- ⁹⁵ Katz, 470
- ⁹⁶ Katz, 472
- ⁹⁷ Katz, 474
- ⁹⁸ Katz, 474
- ⁹⁹ Katz, 474
- ¹⁰⁰ Katz, 476
- ¹⁰¹ Nedelsky, 28
- ¹⁰² Katz, 479
- ¹⁰³ Katz, 481
- ¹⁰⁴ “*Federalist 10*”
- ¹⁰⁵ Nedelsky, 6
- ¹⁰⁶ Nedelsky, 24-30
- ¹⁰⁷ Nedelsky, 26
- ¹⁰⁸ Nedelsky, 19
- ¹⁰⁹ Nedelsky 49
- ¹¹⁰ Nedelsky, 52-53
- ¹¹¹ Nedelsky, 57
- ¹¹² Nedelsky, 51
- ¹¹³ Nedelsky, 51
- ¹¹⁴ Nedelsky, 51
- ¹¹⁵ Nedelsky, 23
- ¹¹⁶ Nedelsky, 28-30
- ¹¹⁷ Nedelsky, 251
- ¹¹⁸ Nedelsky, 7
- ¹¹⁹ Katz, 480
- ¹²⁰ Nedelsky, 67-68
- ¹²¹ Nedelsky, 71
- ¹²² Nedelsky, 72
- ¹²³ Nedelsky, 80
- ¹²⁴ Nedelsky, 83
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- ¹³² Friedman, 1
- ¹³³ "The Louisiana Purchase." *History.com*. N.p., n.d. Web. 20 Mar. 2015. <<http://www.history.com/topics/louisiana-purchase>>.
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- ¹⁴⁹ The Vermont State Constitution
- ¹⁵⁰ Friedman, 6
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- ¹⁵⁴ *Allgeyer v. Louisiana*, 165 U.S. (1897)
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- ¹⁵⁹ Friedman, 17
- ¹⁶⁰ Friedman, 15
- ¹⁶¹ Wallison, 176
- ¹⁶² Monteyne, 2004
- ¹⁶³ In addition to being racist, "redlining" was also deemed unconstitutional in the case *Jones v. Mayer* (1967) where Jones sued a real estate firm that refused to sell him a home in a particular county due to his race. The Court held in favor of Jones, thus indicating that the unofficial practices of "redlining" were unconstitutional.

¹⁶⁴ Monteyne, 2004

¹⁶⁵ Bush, George W. "President Calls for Expanding Opportunities to Homeownership". St. Paul AME Church, Atlanta, Georgia. 17 May 2002.

¹⁶⁶ See works by: Soros, George; Norberg, Johan; Bhide, Amar; Gjerstad, Steven; Smith, Vernon; Stiglitz, Joseph; Wallison, Peter;

¹⁶⁷ "Before the Subcommittee on Domestic Policy, Committee on Oversight and Government Reform, U.S. House of Representatives, at the Carl B. Stokes U.S. Court House, Cleveland, Ohio." *Federalreserve.gov*. The Federal Reserve Bank, 21 May 2007. Web. 6 Apr. 2015.

<<http://www.federalreserve.gov/newsevents/testimony/braunstein20070521a.htm>>.

¹⁶⁸ In other words, a bank receiving FDIC backing

¹⁶⁹ For more information on the Community Reinvestment Act Performance Evaluation, please visit: www2.fdic.gov/crapes/2004/34613_041004.pdf

¹⁷⁰ "Before"

¹⁷¹ The study has since been widely discredited.

¹⁷² Norberg, John. *Financial Fiasco: How America's Infatuation with Homeownership and Easy Money Created the Economic Crisis*. Washington, D.C: Cato Institute, 2009. Print.

¹⁷³ Norberg, 24

¹⁷⁴ Wallison, 174

¹⁷⁵ Wallison, 174

¹⁷⁶ "LMI borrowers" are "Low and Moderate Income Borrowers"

¹⁷⁷ "Before"

¹⁷⁸ According to a study conducted by the Joint Center for Housing Studies at Harvard University, the share of all home mortgages that were traditional (that is, LTVs of 80) decreased from 57.1 percent to 33.1 percent in 2001-2006. In that same timeframe, subprime loans increased from 7.2 to 18.8 percent and Alt-A loans rose from 2.5 percent to 13.9 percent of all mortgages.

¹⁷⁹ Bush

¹⁸⁰ Norberg, 25

¹⁸¹ "MBS Pool Transactions Overview." *Www.fanniemae.com*. Fannie Mae, July 2014. Web. 6 Apr. 2015. <https://www.fanniemae.com/content/fact_sheet/mbs-pool-transactions-overview.pdf>.

¹⁸² Norberg 29-30

¹⁸³ "Subprime" mortgages refer to borrowers who typically have a "subprime" FICO score. Many US institutions define "subprime" as a person who score below a 620 on the FICO scale from 300-850. "Nontraditional" mortgages typically meant mortgages that were not documented. These would include "no-doc" (not documentation) or "low-doc" (low-documentation) loans. The "documentation" refers paperwork included in applying for a loan such as tax returns, evidence of employment, and credit history. "Low-Doc" or "No-doc" loans did not typically take into consideration the previously mentioned documentations to determine creditworthiness of loan applications. (Friedman 17)

¹⁸⁴ Alt-A loans refer to loans made to speculative buyers, or those who received mortgages without the usual underwriting standards.

¹⁸⁵ Due to Countrywide's "special relationship" with Fannie Mae, in the 1990, it was given special discounts and benefits from the GSE.

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- ¹⁸⁶ In 2006, Countrywide opened an entire division that was dedicated to subprime mortgages.
- ¹⁸⁷ Loans with LTVs of 80, meaning 20 percent down and 80 percent mortgaged.
- ¹⁸⁸ Wallison 178
- ¹⁸⁹ For example, in 1989, the Federal Reserve Board denied the Continental Bank Corporation of Illinois' acquisition of the Grand Canyon Bank of Arizona based on low-CRA performance.
<http://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=1375&context=ulj>
- ¹⁹⁰ Refer to Chapter 3, in the discussion of Jefferson's proposal for the Virginia government to provide land for all males of legal age; the Louisiana Purchase.
- ¹⁹¹ "Median Sales Price for New Houses Sold in the United States." *Research.stlouisfed.org*. St. Louis Federal Reserve, Mar. 2015. Web. 24 Apr. 2015. <<https://research.stlouisfed.org/fred2/series/MSPNHSUS>>.
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- ¹⁹³ Friedman, 6
- ¹⁹⁴ "Finance and Economics Discussion Series Divisions of Research & Statistics and Monetary Affairs Federal Reserve Board, Washington, D.C." *Federalreserve.gov*. Federal Reserve Bank, 2008. Web. 14 Apr. 2015.
<<http://www.federalreserve.gov/pubs/feds/2008/200859/200859pap.pdf>>.
- ¹⁹⁵ Low income is defined, by the Community Reinvestment Act guidelines as: "Individual income that is less than 50 percent of the area median income, or a median family income that is less than 50 percent in the case of a geography."
https://www2.fdic.gov/crapes/2004/34613_041004.pdf
- ¹⁹⁶ Friedman, 13
- ¹⁹⁷ Friedman, 16
- ¹⁹⁸ Friedman, 6
- ¹⁹⁹ Acharya, 185
- ²⁰⁰ Acharya, 187
- ²⁰¹ Acharya, 186
- ²⁰² Acharya, 178-179
- ²⁰³ Friedman, 18
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- ²⁰⁵ Friedman, 20
- ²⁰⁶ Friedman, 6
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- ²⁰⁸ Wallison, Peter J. "Credit-Default Swaps and the Crisis." *What Caused the Financial Crisis*. Philadelphia: University Of Pennsylvania, 2011. 238-248. Print.
- ²⁰⁹ Wallison, 238
- ²¹⁰ Wallison 239-240
- ²¹¹ Gethard, Gregory. "Falling Giant: a Case Study of AIG." *Investopedia.com*. Investopedia, 27 Oct. 2008. Web. 4 Apr. 2015.
<<http://www.investopedia.com/articles/economics/09/american-investment-group-aig-bailout.asp>>.

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²¹³ Enomoto, 91

²¹⁴ Enomoto, 91

²¹⁵ Black, Lamont, and Lieu Hazelwood. "The Effect of TARP on Bank Risk-Taking." *Federalreserve.org*. The Federal Reserve Bank, Mar. 2012. Web. 4 Apr. 2015. <<http://www.federalreserve.gov/pubs/ifdp/2012/1043/ifdp1043.pdf>>.

²¹⁶ See Appendix B

²¹⁷ See Appendix C

²¹⁸ Chokshi, Niraj. "For the First Time, the U.S. High School Graduation Rate Tops 80 Percent, Report Finds." *The Washington Post*. Washingtonpost.com, 28 Apr. 2014. Web. 14 Apr. 2015. <<http://www.washingtonpost.com/blogs/govbeat/wp/2014/04/28/for-the-first-time-the-u-s-high-school-graduation-rate-tops-80-percent-report-finds/>>.

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